



# King County

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## MEMORANDUM

**DATE:** December 9, 2008  
**TO:** Metropolitan King County Council  
**FROM:** Cheryle A. Broom, County Auditor  
**SUBJECT:** Financial Audit of Environmental Health Services

Attached for your review is the Financial Audit of Environmental Health Services. The objectives of the audit were to determine whether overhead cost allocations used by Environmental Health Services (EHS) were reasonable and equitable, to determine whether EHS fees were sufficient to cover program costs, and to review how EHS manages its designated fund balance.

Our audit found several areas in which Environmental Health Services could improve. In this audit, we make recommendations to improve the fee-setting methodology and to make financial reporting clearer and more transparent to stakeholders. We also suggest that Environmental Health Services develop a policy regarding the use and balance level of its designated fund balance which carries over fee revenue to the next fiscal year.

The County Executive concurred with the audit findings and recommendations. The executive's official response is included in the appendices of this report.

The Auditor's Office sincerely appreciates the cooperation received from the Environmental Health Services Division of the Department of Public Health and the assistance of the Finance and Business Operations Division, Department of Executive Services.

**FINANCIAL AUDIT**  
**ENVIRONMENTAL HEALTH SERVICES**



**King County**

Presented to  
the Metropolitan King County Council  
General Government and Labor Relations Committee  
by the  
County Auditor's Office

Cheryle A. Broom, King County Auditor  
Allan Thompson, Senior Financial Auditor  
Ron Perry, Deputy Auditor

Report No. 2008-03  
December 9, 2008

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# EXECUTIVE SUMMARY

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## Introduction

The Environmental Health Services Division, within the Department of Public Health, through its permitting and monitoring programs, primarily ensures that there is clean water, clean soil, adequate waste disposal, pest-free homes and businesses, hygienic restaurants, and wholesome food in King County. To accomplish this, Environmental Health Services responsibilities are to:

- Assist in the development and adoption of public health rules and regulations
- Enforce the County Health Code
- Establish requirements for the issuing of permits and licenses
- Develop fees for permits and licenses, subject to the approval of the King County Board of Health

## **Fees May Not Exceed the Cost of Providing the Services**

Most Environmental Health Services programs are supported by fees. The fees are based on an hourly rate which includes overhead charges and any additional costs that are specific to individual programs for which the fee is being charged. By law, the fee that is charged may not exceed the cost of providing the services. By policy of the Board of Health, fees should be set to achieve full cost recovery, including all direct and indirect costs associated with providing the service.

## General Conclusions

We found several areas in which Environmental Health Services could improve their processes and policies especially in the areas concerning the unified hourly rate used to develop fees and the management of the designated fund balance. After a presentation of background information, we divided our main analyses into two chapters: Overhead Rates and Fee Setting.

**Cost of General  
Government Not  
Included**

Overhead Rates

To ensure that cost allocations were reasonable and consistent, we recalculated the overhead cost charges against Environmental Health Services programs and compared the actual totals at the end of 2006 to the budgeted totals. We determined that the amounts charged agreed with the methodology used. We reviewed and compared the allocated cost of overhead charges to actual. There was no significant difference. We also determined that the costs of King County general government are not included in the county overhead cost allocation for environmental health services. We evaluated this issue because recent court rulings have disallowed such costs in overhead and fees.

Fee Setting

The setting and collecting of fees has always been one of the primary responsibilities of Washington State local public health boards and environmental health services. However, the fees were seldom sufficient to cover the cost of those services even though Washington State law gave local health boards the ability to collect fees up to the actual cost of services being provided. In 2005, the Board of Health asked Environmental Health Services (EHS) to develop a fee schedule based in part on a division-wide unified hourly rate using a multi-year approach in establishing and implementing fees. The new fee schedule would determine fees for the next several years and progressively increase those fees yearly to reflect an annual inflation factor. However, budgeted divisional total expenditures used in the development of the unified hourly rate did not agree with the total of the individual programs' budgeted expenditures. An incorrect hourly rate can create the potential that EHS will not fully recover the cost of services provided or may collect a greater amount than is allowable under the cost recovery principle.

**Not All Fee-based Programs May Be Able to Generate Sufficient Revenue**

**Recommendation 1:** We recommend that Environmental Health Services monitor the development of revisions of the unified hourly rate to ensure that sufficient revenue is generated to fully recover, but not exceed, the cost of services.

The current fee setting methodology used a single unified hourly rate of approximately \$150 per hour in the development of cost assumptions for fees, while individual hourly rates by programs varied from \$120 to \$220 per hour. An analysis indicates that under the current methodology of fee development, not all fee-based programs may be able to generate sufficient revenue to recover costs and that the fees generated from programs whose hourly cost is below the unified hourly rate could be subsidizing programs whose hourly cost is above the unified hourly rate.

**Recommendation 2:** EHS should establish a policy of performing a year-end analysis to ascertain the effectiveness of the current rate methodology on a program-by-program basis. This analysis should also determine whether the methodology is achieving the goal of full cost recovery and equity to users.

Fund Balance and Financial Reporting

While working with EHS accounting data and performing analysis, we noted that the 2005 designated fund balance at year end reported in the Comprehensive Annual Financial Report (CAFR) was smaller than the fee revenue surplus shown in ARMS 14<sup>th</sup> month data.

- In 2006, 14<sup>th</sup> month ARMS data showed no surplus or deficit from fee-based programs, but the designated fund balance grew, nonetheless.
- In 2007, ARMS data for fee-based programs indicated that there was an overall surplus of \$215,232 for the year. However, the designated fund balance reported in the CAFR

at the end of 2007 showed a decrease from the prior year of approximately \$36,000.

The overall growth in the designated fund balance indicates that Environmental Health Services has collected more overall revenue than what was needed to recover full cost. Currently there is no written policy covering the use of the fund or desirable retention levels.

**No Written Policy  
Covering the Use of the  
Fund or Desirable  
Retention Levels**

When a fund balance is “designated,” it represents management’s intended future use of resources (e.g., contingencies, equipment replacement)<sup>1</sup> and should generally reflect actual plans approved by senior management.<sup>2</sup> In the case of Environmental Health Services, it is important to have a written policy to address the issue of a designated fund balance and its usage, because fees for services are not to exceed the actual cost of providing the services. An annual reconciliation of funds is needed to achieve clear and transparent reporting of fee revenues.

**Recommendation 3:** We recommend that Environmental Health Services establish policies and procedures related to the designated fund balance. These policies and procedures should establish guidelines on how surpluses and deficits could impact EHS programs and the determination of new fees.

**Recommendation 4:** As part of its policies and procedures related to designated fund balance, Environmental Health Services should perform a yearly reconciliation of surplus fees collected to the designated fund balance and identify and explain any discrepancy.

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<sup>1</sup> NCGA Statement 1, *Government Accounting and Financial Reporting Principles*, paragraph 120.

<sup>2</sup> America Institute of Certified Public Accountants (AICPA), *State and Local Governments*, Section 10.17.

### **Scope and Objectives**

The purpose of our audit was to evaluate the methodology and process by which the Department of Health establishes overhead rates and sets fees for Environmental Health Services programs.

The objectives of the audit were to:

- Determine whether overhead cost allocations were reasonable and equitable.
- Determine whether environmental health service fees were sufficient to cover program costs.
- Review how Environmental Health Services manages its designated fund balance.

Our audit review period covered the years 2005 through 2007.

### **Summary of Executive Response**

The County Executive has provided a response to the recommendations and concurs with all of them. The response also includes proposed implementation timelines. See the appendices section for the complete text of the Executive Response.

### **Acknowledgement**

We thank the staff from Public Health, Environmental Health Services, the Finance Division, and Executive Audit Services for their assistance during the audit.

# 1 INTRODUCTION

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## Objectives

As part of our 2007 work program, we conducted an audit of Environmental Health Services (EHS) for the purpose of evaluating the methodology and process by which the Department of Health establishes overhead rates and sets fees for Environmental Health Services programs.

The objectives of the audit were to:

- Determine whether overhead cost allocations were reasonable and equitable.
- Determine whether environmental health service fees were sufficient to cover program costs.
- Review how Environmental Health Services manages its designated fund balance.

Our audit review period covered the years 2005 through 2007.

## Scope and Methodology

To accomplish the objectives, we reviewed the Revised Code of Washington (RCW) and the King County Code (KCC) related to public health to determine whether Environmental Health Services was in compliance with relevant statutes.

Additionally, we:

- Reviewed the process by which EHS developed its overhead rates and its fee schedule;
- Analyzed the overhead costs charged to the individual programs for accuracy and reasonableness;
- Analyzed the most recent fee schedule prepared by EHS;

- Conducted interviews with EHS staff regarding the cost and level of service being provided;
- Determined the reasonableness of Environmental Health Service's fees by comparing them to those charged by other counties within Washington State;
- Met with various individuals in the Department of Executive Services concerning fee setting, cost allocation, and designated fund balance policies; and
- Analyzed the changes in Environmental Health Services' revenues and expenditures and related fund balances for the years 2005 to 2007.

We conducted this audit in accordance with Generally Accepted Government Auditing Standards.

**Evaluated Internal Controls as Related to Scope and Objectives**

**Internal Control**

We evaluated internal controls as related to the audit's scope and objectives. Based on our analytical procedures, interviews with the department personnel, and the review of policies and procedures, the audit team felt that in general the department's internal control was adequate. However, our recommendation includes areas in which the strengthening of internal controls, particularly in the area of policies and procedures, would improve the timeliness, accurateness, and usefulness of information.

**Data Reliability**

As part of the audit, we made an assessment of the data used in the audit. This assessment was to determine whether or not we could rely on the available data to answer the questions posed by the audit scope and objectives. The assessment was only on those portions of data viewed as relevant to the audit.

Our review of the data is driven by the expected significance of the data to the final report, the anticipated risk level of using the

data, and the strength or weakness of any corroborating evidence. Reliability does not mean that data is error free. But that the data has been assessed and found that any errors that may exist are not significant enough to cause a reasonable person aware of the errors to doubt a finding, conclusion, or recommendation that are based on the data.

While we did note inconsistencies or lack of data, we found no evidence that the data could not support the findings, conclusions, or recommendations in this report.

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# 2 ORGANIZATION AND FUNCTION

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The Environmental Health Services Division, within the Department of Public Health, primarily through its permitting and monitoring programs, ensures that there is clean water, clean soil, adequate waste disposal, pest-free homes and businesses, hygienic restaurants, and wholesome food in King County. To accomplish this, Environmental Health Services responsibilities are to:

- Assist in the development and adoption of public health rules and regulations
- Enforce the Health Code
- Establish requirements for the issuing of permits and licenses
- Develop fees for permits and licenses, subject to the approval of the Board of Health

## **Environmental Health Services Is Organized into Three Sections**

To perform these services the Environmental Health Services Division of Public Health is organized into three sections:

- Food and Facilities Protection - works with establishments open to the public, such as restaurants and swimming pools that can potentially spread disease if not operated or maintained in sanitary condition.
- Environmental Hazards - works in cooperation with state and other local agencies to manage chemical wastes; educates about toxic exposures such as lead and arsenic; supervises solid waste disposal; controls rodent infestations; coordinates responses to vector-borne illnesses such as West Nile virus; responds to indoor air quality and noise pollution problems; and investigates illegal drug laboratories.

- Community Environmental Health - protects the public's health through monitoring, inspecting, and enforcing regulations pertaining to sewage, plumbing, water, and septic systems.

**Most Programs  
Supported by Fees**

Most Environmental Health Services programs are supported by fees. The fees are based on an hourly rate which includes overhead charges and any additional costs that are specific to individual programs for which the fee is being charged.

By law, the fee may not exceed the cost of providing the services. By policy of the Board of Health, fees should be set to achieve full cost recovery, including all direct and indirect cost associated with providing the service.

# 3 OVERHEAD RATES

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## Costs Allocated in a Reasonable and Equitable Methodology

To fulfill the requirement of full cost recovery, Environmental Health Services needs to ensure that all costs associated with fee-based programs are allocated in a reasonable and equitable methodology. The amount of cost that a program incurs is determined by the type of services needed and the amount of the service used. Therefore, costs are usually divided into two categories.

Those categories are:

- Direct costs - costs which can be identified specifically with a particular activity and which can be directly assigned to such activity. These costs are relatively easy to identify and are recorded with a high degree of accuracy. Examples of direct costs are payroll costs, legal expenses, telephone charges, travel expenses, postage, and office supplies.
- Indirect costs (also referred to as overhead costs) - costs an organization incurs for common or joint objectives that cannot be readily and specifically identified with a particular activity. The majority of these expenditures include management and administrative staff payroll cost as well as the EHS's share of the Director of Public Health cost and divisional administrative costs.

For the indirect cost charged to EHS fee-based programs, there are three types of overhead costs that need allocation. Those are the costs associated with the county (county overhead costs), the costs associated with the department (departmental overhead costs), and the costs associated with the division (divisional overhead costs). Each of these overhead costs is represented in

the indirect cost category and denotes a group of services that provide benefit to environmental health programs.

While we reviewed all overhead costs and the allocation methods, we centered our analysis specifically on county overhead. We did this because we wanted to ensure that county overhead costs were allocated reasonably and equitably, and that they did not include the cost of general government. General government cost, such as the cost of elected officials, can only be allocated to a fund if two requirements are met:

- The legal restrictions of the fund do not prohibit the county from spending the revenues on general government costs, and
- The cost allocations reflect the ‘true and fair’ value of those services rendered to the fund.

The Washington State Auditor’s Office determined that King County’s current allocation methodology pertaining to elected officials does not reflect the true and fair value of services rendered. Therefore, it is not appropriate to allocate these costs.

Our analysis did show that county overhead is comprised of three separate types of cost. They are:

- General County Overhead
- County Information Technology Systems and Office of Information Resource Management (OIRM) Overhead
- County Finance Overhead

For each type of overhead cost there is a distinct allocation method.

- General County Overhead is allocated by percentage of actual expenditures
- County Information Technology Systems and OIRM Overhead is allocated by percentage of computers

- County Finance Overhead is allocated by percentage of transaction counts

The sum of these three allocation methods equals the total county overhead cost charged against environmental health programs.

For 2006, Environmental Health Services had the following county overhead cost allocations:

<b>EXHIBIT A</b>	
<b>County Overhead</b>	
<b>2006</b>	
General County Overhead	\$394,333
County Information Technology Systems and OIRM Overhead	48,665
County Finance Overhead	290,624
<b>Total</b>	<b>\$733,621</b>

**SOURCE:** Environmental Health Services

**General Government  
Costs Are Not Included  
in Overhead Cost  
Allocations**

To ensure that cost allocations were reasonable and consistent, we recalculated the overhead cost charges against public health programs and compared the actual totals at the end of 2006 to the budget totals. We determined that the amounts charged agreed with the methodology used. We also reviewed and compared the allocated cost of EHS overhead charges to actual. There was no significant difference. In addition, we determined that the costs of King County general government are not included in the county overhead cost allocations for environmental health services.

Our conclusion is that county overhead cost allocations are accurate, reasonable, and equitable based on the allocation methodologies used by Environmental Health Services and the Department of Public Health. Thus, they are in compliance with county policy.

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# 4 FEE SETTING

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## **In the Past, Fees Seldom Sufficient to Cover Cost**

The setting and collecting of fees has always been one of the primary responsibilities of Washington State local public health boards and environmental health services. While the fees collected have been integral parts of the revenue available for environmental health services, they were seldom sufficient to cover the cost of those services even though Washington State law gave local health boards the ability to collect fees up to the actual cost of services being provided.<sup>3</sup>

In the recent past, to support programs, local health boards drew revenue from a variety of funding sources; among them was the Motor Vehicle Excise Tax. However in 1999, with the passage of Initiative 695, which reduced the Motor Vehicle Excise Tax to \$30, Public Health lost those dollars.

Subsequently, in an effort to help alleviate revenue loss, many local health boards approved their environmental health services programs to increase the fees to cover the full cost of their respective programs, if it was not already occurring.

In King County, prior to 2005, what had evolved in an effort to reduce the loss of revenue was a situation whereby each individual environmental health program (for example: restaurant inspections, septic design review, solid waste plan reviews) developed its own fee schedules and hourly rates independently of each other. This created a situation in which EHS programs frequently sought the Board of Health approval to update fees. The practice, according to Public Health, was time consuming and inefficient.

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<sup>3</sup> RCW 70.05.060

In 2005, the Board of Health asked Environmental Health Services to develop a fee schedule based on a division-wide unified hourly rate using a multi-year approach in establishing and implementing fees. The new fee schedule would determine fees for the next several years and progressively increase those fees yearly to reflect an annual inflation factor.

**Fee Should Be Set to Achieve Full Cost Recovery**

The effect of shifting from a program-specific rate to a division-wide unified rate created a number of changes for Public Health. Among those was to amend King County Code from multiple fee titles by program to a single fee title by division. In addition, the Board of Health adopted a single fee schedule for all EHS fee based programs. The underlying basis for fee development, both within the RCW's and EHS's own fee setting principles, is that fees should be set to achieve full cost recovery, including all direct and indirect costs associated with providing the services and nothing more.

To accommodate the new fee setting methodology, the Board of Health and Environmental Health Services developed the following rationale in establishing the new fee schedule and unified hourly rate.<sup>4</sup>

1. Full Cost Recovery: Fees should be set to achieve full cost recovery, including all direct and indirect costs associated with providing the services. Full costs included direct service costs, supervision, administration, technology, county-wide overhead charges, and other expenditures that may be associated with the EHS programs.
2. Unified Hourly Rate: A fee schedule should be calculated by using a unified hourly rate based on full cost of services for the entire EHS division instead of the program-specific hourly rate.

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<sup>4</sup> 1/4/05 Draft of Environmental Health Unified Hourly Rate and Division Fee Schedule Proposal

3. Non Fee-Based Funding Support: A division policy guideline that would delineate which environmental health services should be supported by fee revenues and which should be supported by other funding. The programs that provide services to the general public that could not be tied back to a permit-related function would be funded through a stable and predictable non fee-based funding source. Each program in EHS would be identified as either fee-based or non fee-based depending on the nature of the services.
4. Review Requirements: The Board of Health would review all fees and calculation methodology on a “regular” basis (e.g., every 3-5 years). The division could return to the board with recommendations for fee decreases or increases if there is any unforeseen positive or negative variance between the fees charged and the actual cost of services.

Environmental Health Services noted “With the new EHS fee schedule, the financial management practice would be shifted to the division level rather than program level. While financial monitoring will continue at the program level, the management of the fund will shift to the division level.”<sup>5</sup>

#### **Annual Inflation Factor**

Finally, the new fee schedule was established for the next three to five years, which included an annual inflation factor of five percent added each year to the cost of permits until the Environmental Health Services and the Board of Health developed a new unified hourly rate and fee schedule.

Currently the majority of EHS revenue is generated by the collection of fees which is done through the issuance of licenses and permits, inspections, examination fees, and charges for services.

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<sup>5</sup> 1/4/05 Draft of Environmental Health Unified Hourly Rate and Division Fee Schedule Proposal

Fees are collected continually throughout the year and are recorded on a program-by-program basis. The largest portion of revenue comes from the four programs highlighted in Exhibit B. These programs were responsible for generating 75 percent to 80 percent of the total revenue for the years 2005 through 2007.

**EXHIBIT B****Fee Revenue by Program  
2005-2007**

<b>Program Activities</b>	<b>2005</b>	<b>%</b>	<b>2006</b>	<b>%</b>	<b>2007</b>	<b>%</b>
<b>Food Protection</b>	<b>\$7,143,928</b>	<b>36%</b>	<b>\$7,143,928</b>	<b>36%</b>	<b>\$7,672,913</b>	<b>39%</b>
<b>Plumbing/Gas Piping</b>	<b>3,842,278</b>	<b>19%</b>	<b>3,842,278</b>	<b>19%</b>	<b>3,868,925</b>	<b>20%</b>
<b>Hazard Waste Plan</b> *	<b>2,359,091</b>	<b>12%</b>	<b>2,359,091</b>	<b>12%</b>	<b>2,731,462</b>	<b>14%</b>
<b>Waste Water Disposal</b>	<b>1,491,232</b>	<b>8%</b>	<b>1,491,232</b>	<b>8%</b>	<b>1,597,778</b>	<b>8%</b>
<b>Subtotal</b>	<b>\$14,836,529</b>	<b>75%</b>	<b>\$14,836,529</b>	<b>75%</b>	<b>\$15,871,078</b>	<b>80%</b>
Solid Waste	\$ 1,388,087	7%	\$ 1,124,131	6%	\$ 950,772	5%
Living Environment	1,376,300	7%	1,376,300	7%	911,444	5%
Vector/Nuisance Control	797,771	4%	797,771	4%	882,263	4%
Drinking Water Protection	421,950	2%	520,624	3%	495,910	3%
Site Hazard Plan	266,588	1%	330,931	2%	248,762	1%
Chemical/Physical Hazards	130,927	1%	291,234	1%	208,360	1%
Meth Labs	328,295	2%	247,639	1%	189,950	1%
Meat Inspection	332,197	2%	295,101	1%		0%
<b>Subtotal</b>	<b>\$ 5,042,115</b>	<b>25%</b>	<b>\$ 4,983,731</b>	<b>25%</b>	<b>\$ 3,887,461</b>	<b>20%</b>
<b>Grand Total</b>	<b>\$19,878,644</b>	<b>100%</b>	<b>\$19,820,260</b>	<b>100%</b>	<b>\$19,758,539</b>	<b>100%</b>

**SOURCE:** ARMS

\* – These programs are not fee supported programs; however, they were included in development of the unified hourly rate.

\*\* – Drinking Water is a mix of fee and non-fee revenue; however, this program was included in the development of the unified hourly rate calculation.

As previously stated, in 2005, Environment Health Services developed a new fee schedule. The fee schedule was based on a unified hourly rate for the entire division. To determine the unified rate, Environmental Health Services took the total budgeted divisional expenditures by program and divided by the estimated yearly total hours needed to complete the required tasks. The calculated unified hourly rate was \$149.78 per hour. During our analysis and review of the methodology used to develop the division-wide unified hourly rate, we identified

approximately \$620,000 in budgeted expenditures that were excluded from the amount recognized as the total divisional budgeted expenditures for the purposes of rate development.

When the additional budgeted expenditures are included in a recalculation of the division-wide unified rate, the hourly rate is increased by \$5.50 per hour. (See Exhibit C.)

**EXHIBIT C**  
**Comparative Analysis of Budgeted Cost Used in the Unified Hourly Rate**  
**2005**

Environmental Health 2005 Hourly Rate		As determined	As determined	
Based on 2005 adopted Budget		by EHS	by KCAO	
Account	Expenditure Category	Division Total	Division Total	Difference
51000	Professional Staff	\$6,631,793	\$6,725,557	\$93,764
51000	Clerical Staff	919,493	992,261	72,768
51000	Supervisory Staff	728,390	728,390	0
51300	Benefits	2,792,774	2,860,191	67,417
52000	Supplies	220,099	248,257	28,158
53000	Services & Charges	789,899	969,178	179,279
55000	O&M	735,163	765,456	30,293
55000	Indirect - County	654,072	681,845	27,773
55000	Indirect - Department	1,323,474	1,373,671	50,197
55000	Indirect - Division	334,319	399,177	64,858
55000	Site Management	1,571,142	1,571,142	0
56000	Capital Equipment	27,001	30,501	3,500
59000	Contingency - COLA	231,952	236,774	4,822
	<b>Total Budget</b>	<b>\$16,959,571</b>	<b>\$17,582,400</b>	<b>\$622,829</b>
	2005 Direct Hours Workplan	113,232	113,232	
	<b>Cost per Direct Service Hour</b>	<b>\$149.78</b>	<b>\$155.28</b>	<b>\$5.50</b>

**SOURCE:** Environmental Health Services

**Finding:** Budgeted divisional total expenditures used in the development of the unified hourly rate did not agree with the total of the individual programs' budgeted expenditures. The result was that the amount of unified hourly rate charged by EHS was less than the budgeted full cost of services.

Environmental Health Services did not sufficiently monitor the development of the unified hourly rate to ensure that all expenditures were included. An incorrect hourly rate can create the potential that programs will not fully recover the cost of services provided or may collect a greater amount than is allowable under the cost recovery principle.

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**RECOMMENDATION 1**

We recommend that Environmental Health Services ensure that it monitors the development of revisions to the unified hourly rate to ensure that sufficient revenue is generated to fully recover the cost of services.

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**Additional Components of Rate Setting**

The unified hourly rate is the basis for all hourly charges for service and permit fees. However, there are additional components that Environmental Health Services considers in the setting of permit fees.

Those components are:

- Permit – different permits provide different types and levels of service.
- Type, level, and number of services that are provided per that peculiar permit type. (We have prepared a detailed example of one type of permit fee cost calculation in Appendix 2.)

**Equity of Fees**

We analyzed the effect of the unified hourly rate and these components on individual fee-based programs within EHS. While we are able to show whether each program generated either a surplus or deficits (See Appendix 1, Tables 1, 2, & 3), we were unable to determine how the surplus or deficit was integrated into the fee setting process or the possible impact on the users of EHS services.

**Fee Surpluses From One Program May Have Been Used to Support Programs That Had Deficits**

The current fee setting methodology uses a single unified hourly rate of approximately \$150 per hour in the development of cost assumptions for fees, while individual hourly rates by programs vary from \$120 to \$220 per hour. The analysis indicates that under the current methodology of fee development, not all fee-based programs may be able to generate sufficient revenue to recover costs. The fees generated from programs whose hourly cost is below the unified hourly rate may be subsidizing programs whose hourly cost is above the unified hourly rate. Additionally, when the surplus and deficits produced by individual programs are examined in relationship to fund balance, the review indicates that surpluses from one program may have been used to support programs that had deficits.

**Finding:** From the material provided, it does not appear that EHS has performed or developed policies and procedures to ensure that the current fee methodology is effective in recovering program costs and ensuring the equity of fees paid by users of services.

**RECOMMENDATION 2**

EHS should establish a policy and practice of performing a year-end analysis to ascertain the effectiveness of the current rate methodology on a program-by-program basis. This analysis

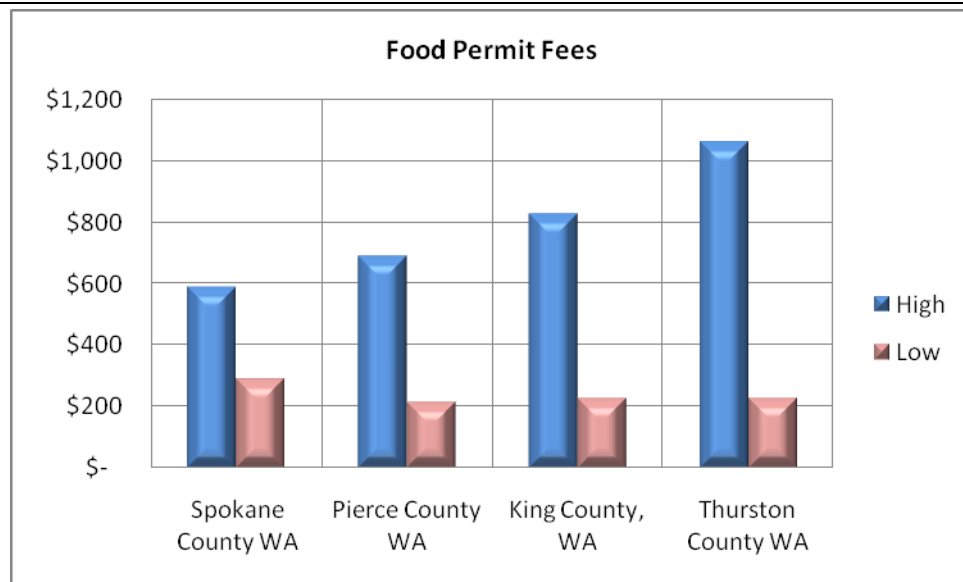
should also determine whether the methodology is achieving the goal of full cost recovery and equity to its users.

**Permit Fee Comparison**

We compared the range of cost for food establishment permit fees in King County to four other counties in Washington State for 2007. Recognizing that various factors contribute to the cost of providing environmental health services, it is not possible to determine the cost effectiveness and efficiency of EHS activities. However, the data does indicate that the EHS permit fees are comparatively reasonable from this comparison alone.

**EXHIBIT D**

**Food Permit Fee Comparison  
Washington Counties**



**SOURCE:** King County Auditor's Office

**Designated Fund Balance**

In analyzing the revenues, expenditures and fund balance of Environmental Health Service programs over the last five years, we noted that EHS was reporting a positive fund balance in the CAFR for the years 2004 to 2007. This fund balance is

equivalent to approximately 20% of the annual operating expenditures of EHS fee based programs. A positive fund balance indicates that revenues have exceeded expenditures.

**2004, Surplus Fees  
\$3.2 Million**

The accounting practices changed in 2005. Prior to that date surplus fees that had been collected and accumulated over time were recorded as “deferred revenue.” Then each year the accumulated “deferred revenue” from surplus fees was reallocated to the program that had collected them. In 2004, the accumulated “deferred revenue” from surplus fees was \$3.2 million.

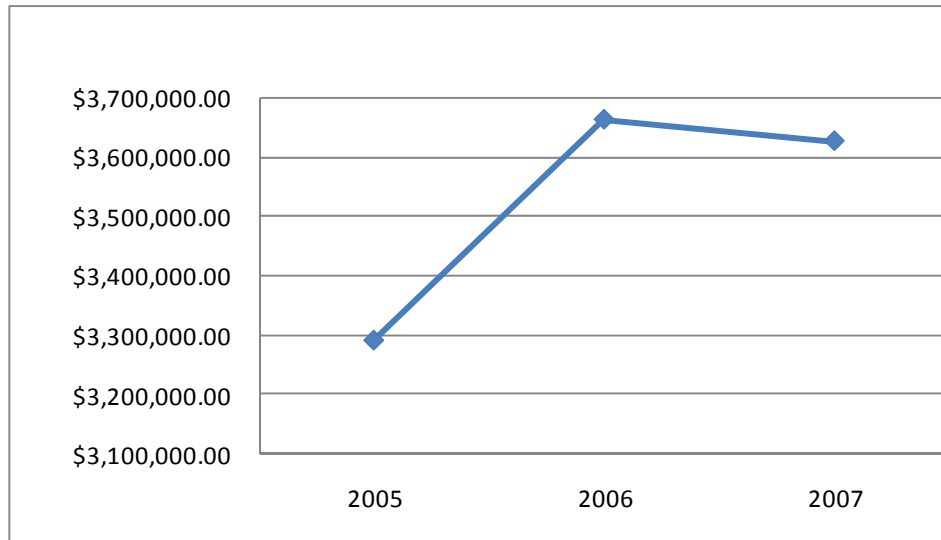
In 2005, the Washington State Auditor’s Office and King County Executive Audit Services determined that this method of classifying, recording, and reallocation of surplus fees was not appropriate.<sup>6</sup> The appropriate method was for surplus fees to carry forward to the “unreserved fund balance” and be shown in the CAFR as a designated fund balance for Environmental Health Services. The purpose of the designated fund balance is to segregate and identify the total of the accumulated environmental health fee revenue that has been collected over time so that it can be used by EHS in the future.

The exhibit below shows the designated fund balance for 2005 through 2007.

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<sup>6</sup> Per discussion with Executive Audit Services.

**EXHIBIT E**  
**Environmental Health Services Designated Fund Balance**  
**2005-2007**



**SOURCE:** 2005, 2006 and 2007 CAFRs

To help determine the impact of EHS fee-based programs on the designated fund balance, we developed summary tables from ARMS, the county's financial system. From these tables we developed Exhibit F and Appendix 1.

**Reallocation of  
Accumulated Surplus  
Fees**

While working with this data and performing analysis, we noted that several fee-based programs showed a surplus in 2005, some of which was due to the reallocation of accumulated surplus fees (i.e. deferred revenue), as discussed previously. However, the designated fund balance at year end reported in the CAFR is smaller than the surplus shown in ARMS 14<sup>th</sup> month data. (See Exhibit F, line 1.)

In 2006, 14<sup>th</sup> month ARMs data showed no surplus or deficit from fee-based programs, but the designated fund balance grew nonetheless. This indicated that Environmental Health Services fee-based programs had generated an overall surplus, though

none was shown in the 14<sup>th</sup> month financial data. (See Exhibit F, line 2.)

In 2007, ARMS data for fee-based programs indicated that there was an overall surplus of \$215,232 for the year (see Exhibit F, line 3). However the designated fund balance reported in the CAFR at the end of 2007 showed a decrease from the prior year of approximately \$36,000.

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**EXHIBIT F**

**Total Revenue and Expenditures w/Fund Balance  
2005-2007, 14th Month Summary**

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<u>Year</u>	<u>Total Expenditures</u>	<u>Total Revenues</u>	<u>Surplus (Deficit)</u>	<u>CAFR Fund Balance</u>
<b>2005</b>	\$ 16,571,227	\$ 19,878,644	\$ 3,307,417	\$ 3,289,895
<b>2006</b>	\$ 18,300,063	\$ 18,300,063	\$ -	\$ 3,661,523
<b>2007</b>	\$ 19,543,307	\$ 19,758,539	\$ 215,232	\$ 3,625,458

**SOURCE:** ARMS

The growth in the designated fund balance over time, as shown in Exhibits E & F indicates that Environmental Health Services has collected more overall revenue than what was needed to recover full cost.

When a fund balance is “designated” it represents management’s intended future use of resources (e.g., contingencies, equipment replacement)<sup>7</sup> and should generally reflect actual plans approved by senior management.<sup>8</sup> In the case of Environmental Health Services, it is important to address the issue of a designated fund balance and its usage because fees for services are not to exceed the actual cost of providing the services.

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<sup>7</sup> NCGA Statement 1, *Government Accounting and Financial Reporting Principles*, paragraph 120

<sup>8</sup> America Institute of Certified Public Accountants (AICPA), *State and Local Governments*, Section 10.17

**Finding:** We could find no plans, policies, or procedures that documented management's intended use of the designated fund balance. Because of the absence of policies and procedures, it is difficult to determine the possible financial impact that the designated fund balance may have on Environmental Health Services and on the public that pay for EHS services.

The absence of plans, policies, or procedures regarding the use of designated fund balance and future rate changes raises additional issues, such as:

- Transparency and accountability appear to be lacking; and
- There is no methodology or guidance on how surpluses and /or deficits are to be factored in the setting of new fees.
- Additionally, it may lead to misunderstandings on the part of the individuals and businesses that pay permit fees and hourly charges to EHS for services.

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**RECOMMENDATION 3**

We recommend that Environmental Health Services establish policies and procedures related to the designated fund balance in order to improve transparency and accountability of the rates and the programs. These policies and procedures should also establish guidelines on how surpluses and deficits could impact EHS programs and the determination of new fees.

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**Finding:** Based on discussions with EHS personnel, analysis of financial data, and analytical procedures, we would expect that the designated fund balance shown in the CAFR would be the same amount as the accumulated surplus fees that have been generated by the fee-based programs. Because the two amounts are not the same, it could indicate that surplus fees from fee-based programs were used to support non fee-based programs. However the limitations of the financial data do not enable us to

make such a determination. The fact that these two amounts do not reconcile raises questions about the accuracy of the financial reporting and reduces clarity over whether or not the fees are covering costs.

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**RECOMMENDATION 4**

As part of its policies and procedures related to designated fund balance, Environmental Health Services should perform a yearly reconciliation of surplus fees collected to the designated fund balance and identify and explain any discrepancies.

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## **APPENDICES**

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**APPENDIX 1**

**PROGRAM ACTIVITY TABLES**

**TABLE 1  
Program Activity – 14<sup>th</sup> Month, 2005**

2005 14th Month					
Program Activities	Cost		Total	Total	Surplus
	Direct	Indirect	Expenditures	Revenues	(Deficit)
Drinking Water Protection	302,067	119,883	421,950	421,950	-
Solid Waste	748,073	273,270	1,021,343	1,388,087	366,744
Site Hazard Plan	187,996	78,592	266,588	266,588	-
Meth Labs	231,784	97,719	329,503	328,295	(1,208)
Chemical/Physical Hazards	87,118	43,860	130,978	130,927	(51)
Hazard Waste Plan	1,705,380	653,914	2,359,294	2,359,091	(203)
Food Protection	4,273,088	1,666,114	5,939,202	7,143,928	1,204,726
Meat Inspection	208,312	123,885	332,197	332,197	-
Living Environment	552,230	280,288	832,518	1,376,300	543,782
Vector/Nuisance Control	553,670	214,260	767,931	797,771	29,840
Plumping/Gas Piping	2,010,289	668,202	2,678,491	3,842,278	1,163,787
Waste Water Disposal	1,073,040	418,192	1,491,232	1,491,232	-
Total			16,571,227	19,878,644	3,307,417
<b>Designated Fund Balance per CAFR</b>					<b>3,289,895</b>

**SOURCE:** ARMS

**TABLE 2  
Program Activity – 14<sup>th</sup> Month, 2006**

2006 14th Month					
Program Activities	Cost		Total	Total	Surplus
	Direct	Indirect	Expenditures	Revenues	(Deficit)
Drinking Water Protection	370,956	149,668	520,624	520,624	-
Solid Waste	777,597	346,534	1,124,131	1,124,131	-
Site Hazard Plan	234,263	96,668	330,931	330,931	-
Meth Labs	160,740	86,899	247,639	247,639	-
Chemical/Physical Hazards	205,241	75,993	281,234	281,234	-
Hazard Waste Plan	1,714,581	738,401	2,441,654	2,441,654	-
Food Protection	4,789,917	1,834,402	6,624,320	6,624,320	-
Meat Inspection	176,347	118,754	295,101	295,101	-
Living Environment	613,671	298,489	912,160	912,160	-
Vector/Nuisance Control	665,436	267,318	932,754	932,754	-
Plumping/Gas Piping	2,097,899	758,321	2,856,220	2,856,220	-
Waste Water Disposal	1,228,893	504,402	1,733,295	1,733,295	-
Total			18,300,063	18,300,063	-
<b>Designated Fund Balance per CAFR</b>					<b>3,661,523</b>

**SOURCE:** ARMS

**APPENDIX 1 (Continued)**

**TABLE 3  
Program Activity – 14<sup>th</sup> Month, 2007**

2007 14th Month						
Program Activities	1	Cost		Total	Total	Surplus
		Direct	Indirect	Expenditures	Revenues	(Deficit)
Drinking Water Protection		364,658	146,785	511,443	495,910	(15,533)
Solid Waste		65,627	360,655	1,012,281	950,772	(61,509)
Site Hazard Plan		208,627	105,477	314,104	248,762	(65,342)
Meth Labs		163,741	83,165	246,906	189,950	(56,956)
Chemical/Physical Hazards		176,478	86,898	263,376	208,360	(55,016)
Hazard Waste Plan		1,875,204	858,678	2,733,882	2,731,462	(2,420)
Food Protection		5,235,406	2,186,366	7,421,772	7,672,913	251,141
Meat Inspection						
Living Environment		678,718	353,336	1,032,054	911,444	(120,610)
Vector/Nuisance Control		703,885	321,433	1,025,318	882,263	(143,055)
Plumping/Gas Piping		2,311,735	811,428	3,123,163	3,868,925	745,762
Waste Water Disposal		1,312,768	546,239	1,859,007	1,597,778	(261,229)
Total				19,543,307	19,758,539	215,232
<b>Designated Fund Balance per CAFR</b>						<b>3,625,458</b>

**SOURCE:** ARMS

**Footnote 1** – The program activities listed in the tables above were used by Environmental Health Services in the development of the unified hourly rate. However, not all programs are fee based. Drinking Water Protection is a mix of fee and non-fee revenue, while Site Hazard Plan, Meth Labs, Chemical/Physical Hazards, Hazard Waste Plan and Vector/Nuisance Control are non-fee supported programs

## APPENDIX 2

### DETAILED EXAMPLE OF PERMIT FEE STRUCTURE

To determine the cost of permit fees charged by Environmental Health Service Programs there are three items that need to be determined. Those items are:

1. The unified hourly rate.
2. Permit type.
3. Type, level, and number of services that are provided for the peculiar permit type.

In this example, we recalculate the base year (2005) permit fee for an eating establishment, with a seating capacity of 13-50 people and assigned a risk category of 1. (The risk category is the measure system used by EHS to identify establishments that are shown to require a higher level of environmental health services. Category 1 is the lowest risk and therefore a lowest cost. Category 3 is highest risk and therefore higher cost.)

#### Item 1: Unified hourly rate

The unified hourly rate has been determined to be \$149.78 per hour.

#### Item 2: Permit type

The permit type has been identified as being for an eating establishment with a seating capacity of 13-50 people, with an assigned risk category of 1 the lowest risk category.

#### Item 3: Identify the type, level, and number of services provided

- a. Routine Inspection (1-The number of times the establishment has an inspection, the number of visits is linked to the risk category. Category 1 establishments are charged for one visit per year, and Categories 2 and 3 establishments are charged for 2 visits per year.)
- b. Code Enforcement (20%=0.2)
- c. Education Service (80%=0.8)
- d. Investigation (40%=0.4)

The number in parentheses next to the services in items b, c, and, d represents the percentage of total establishments that have received coded enforcement, education, and investigation services. This factor is used later in the determination of total hours.

Because EHS has the ability to track time by task code in a program named Envision, EHS is able to determine the amount of time required for each type of service activity. For the services shown above, the amount of time per service required is:

- a. Routine Inspection (Category 1 – 1 inspection, **1.07** hrs)
- b. Code Enforcement (**0.9** of an hour)
- c. Education Service (**0.3** of an hour)
- d. Investigation (**0.7** of an hour)

## APPENDIX 2 (Continued)

To determine the total service hours per permit issued, the time to perform the services is multiplied by the factor shown in parentheses originally shown above, by the hours or portion of an hour needed to provide that peculiar service. The results of each calculation are added together to determine total number of hours. (Bolded numbers are the estimated time to perform the services.)

- a. Routine Inspection ( Category 1 – 1.0 x **1.07**= 1.07)
- b. Code Enforcement (0.2 x **0.9**= 0.17)
- c. Education Service (0.8 x **0.3**= 0.24)
- d. Investigation (0.4 x **0.7**= 0.28)

The total hours per permit for an eating establishment sitting 13-50 individuals and classified as a Category 1 eating establishment is 1.76,<sup>9</sup> total hours. The cost of a permit in dollars would be total hours multiplied by the unified hourly rate, or 1.76 x 149.78, which equals 263.61. This agrees with the 2005 permit cost of \$264.

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<sup>9</sup> 1.07+0.17+0.24+0.28= 1.76

## LIST OF FINDINGS, RECOMMENDATIONS & IMPLEMENTATION SCHEDULE

**Finding:** Budgeted divisional total expenditures used in the development of the unified hourly rate did not agree with the total of the individual programs' budgeted expenditures. The result was that the amount of unified hourly rate charged by EHS was less than the budgeted full cost of services.

Environmental Health Services did not sufficiently monitor the development of the unified hourly rate to ensure that all expenditures were included. An incorrect hourly rate can create the potential that programs will not fully recover the cost of services provided or may collect a greater amount than is allowable under the cost recovery principle.

**Recommendation 1:** We recommend that Environmental Health Services ensure that it monitors the development of revisions to the unified hourly rate to ensure that sufficient revenue is generated to fully recover the cost of services.

**Implementation Date:** December 2008 – January 2009

**Estimate of Impact:** Proper monitoring of the development of the unified hourly rate improves the likelihood that EHS will receive sufficient revenue to fully recover the cost of services ensuring that fee-based programs are self-sufficient.

**Finding:** From the material provided, it does not appear that EHS has performed or developed policies and procedures to ensure that the current fee methodology is effective in recovering program costs and ensuring the equity of fees paid by users of services.

**Recommendation 2:** EHS should establish a policy and practice of performing a year-end analysis to ascertain the effectiveness of the current rate methodology on a program-by-program basis. This analysis should also determine whether the methodology is achieving the goal of full cost recovery and equity to its users.

**Implementation Date:** April – May 2009 as part of year-end 2008 activity

**Estimate of Impact:** By performing year-end analysis on a program-by-program basis, EHS can determine if individual fee-based programs are recovering the full cost of providing services and determine if users are receiving services at the appropriate cost.

**Finding:** We could find no plans, policies, or procedures that documented management's intended use of the designated fund balance. Because of the absence of policies and procedures it is difficult to determine the possible financial impact that the designated fund balance may have on Environmental Health Services and on the public that pay for EHS services.

The absence of plans, policies, or procedures regarding the use of designated fund balance and future rate changes raises additional issues, such as:

- Transparency and accountability appear to be lacking; and
- There is no methodology or guidance on how surpluses and /or deficits are to be factored in the setting of new fees.

## LIST OF FINDINGS, RECOMMENDATIONS & IMPLEMENTATION SCHEDULE (Continued)

- Additionally, it may lead to misunderstandings on the part of the individuals and business that pay permit fees and hourly charges to EHS for services.

**Recommendation 3:** We recommend that Environmental Health Services establish policies and procedures related to the designated fund balance in order to improve transparency and accountability of the rates and the programs. These policies and procedures should also establish guidelines on how surpluses and deficits could impact EHS programs and the determination of new fees.

**Implementation Date:** July 2009

**Estimate of Impact:** By establishing policies and procedures for the designated fund balance, EHS improves accountability and ensures that the fund balance is used specifically for the improvement of environmental health services.

**Finding:** Based on discussions with EHS personnel, analysis of financial data, and analytical procedures, we would expect that the designated fund balance shown in the CAFR would be the same amount as the accumulated surplus fees that have been generated by the fee-based programs. Because the two amounts are not the same, it could indicate that surplus fees from fee-based program were used to support non fee-based programs. However the limitations of the financial data do not enable us to make such a determination. The fact that these two amounts do not reconcile raises questions about the accuracy of the financial reporting and reduces clarity over whether or not the fees are covering costs.

**Recommendation 4:** As part of its policies and procedures related to designated fund balance, Environmental Health Services should perform a yearly reconciliation of surplus fees collected to the designated fund balance and identify and explain any discrepancy.

**Implementation Date:** July 2009

**Estimate of Impact:** By performing a yearly reconciliation of the fund balance to surplus fees collected, EHS can ensure that fee-based programs are not improperly supporting non fee-based programs and that the users of fee-based programs are being charged appropriately.

## EXECUTIVE RESPONSE



**King County**

**Ron Sims**  
King County Executive  
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**KING COUNTY AUDITOR**

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December 1, 2008

Cheryle A. Broom  
King County Auditor  
Room 1033  
C O U R T H O U S E

RE: Financial Audit - Environmental Health Services

Dear Ms. Broom:

Thank you for your November 13, 2008 letter and the opportunity to respond to the proposed Financial Audit for Environmental Health Services.

The audit of Environmental Health Services reviewed the allocation of overhead in the fees, whether the fees are sufficient to cover regulatory program costs, and how the designated reserve for Environmental Health in the Public Health Fund is managed. We agree with the audit's recommendations and have already begun to use what was learned during the audit process to modify an upcoming fee proposal that will go to the King County Board of Health in the near future. The recommended development of policies and procedures for the designated reserve, which we anticipate will be completed by the end of the second quarter of 2009, will also result in improvements in our financial practices.

We would like to acknowledge the helpful professional approach and assistance provided by your audit team. Their recommendations will result in more effective service to the public by improving the fee-setting methodology and financial reporting of the Environmental Health Services Division of the Public Health Department.

Attached is our detailed response to the audit's recommendations in the table format requested.

Sincerely,

Ron Sims  
King County Executive

cc: David Fleming, M.D., Director, Public Health – Seattle & King County (PHSKC)  
Ngozi Oleru, Ph.D., Director, Environmental Health Services Division, PHSKC  
Benjamin Leifer, Chief Administrative Officer, PHSKC  
Allan Thompson, Senior Financial Auditor, King County Auditor's Office  
Ron Perry, Deputy Auditor, King County Auditor's Office



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## EXECUTIVE RESPONSE (Continued)

### Executive Response to Financial Audit – Environmental Health Services

Recommendation	Agency Position	Schedule for Implementation	Comments
<p><b>Recommendation #1</b> We recommend that Environmental Health Services monitor the development of revisions of the unified hourly rate to ensure that sufficient revenue is generated to fully recover, but not exceed, the cost of services.</p>	Concur	December 2008 - January 2009	<p>The department is updating its Environmental Health unified hourly rate formulation in a manner consistent with the audit recommendations. A fee proposal going to the Board of Health in the near future reflects this updated approach.</p>
<p><b>Recommendation #2</b> EHS should establish a policy of performing a year-end analysis to ascertain the effectiveness of the current rate methodology on a program-by-program basis. This analysis should also determine whether the methodology is achieving the goal of full cost recovery and equity to users.</p>	Concur	April-May 2009 as part of year-end 2008 activity.	<p>The department will perform annual year-end analyses to determine the effectiveness of the rate setting methodology in achieving full cost recovery and user equity as recommended. The first analysis will be performed in April 2009 for calendar/fiscal year 2008 after the 14<sup>th</sup> month financial reports are available.</p>

## EXECUTIVE RESPONSE (Continued)

### Executive Response to Financial Audit – Environmental Health Services

<p><b>Recommendation #3</b> We recommend that Environmental Health Services establish policies and procedures related to the designated fund balance. These policies and procedures should establish guidelines on how surpluses and deficits could impact EHS programs and the determination of new fees.</p>	<p>Concur</p>	<p>July 2009.</p>	<p>The department will develop a policy for the Environmental Health designated reserve that will include guidelines for appropriate levels and uses of the reserve. The department plans to have the policy developed by the beginning of July 2009.</p>
<p><b>Recommendation #4</b> As part of its policies and procedures related to designated fund balance, Environmental Health Services should perform a yearly reconciliation of surplus fees collected to the designated fund balance and identify and explain any discrepancy.</p>	<p>Concur</p>	<p>July 2009.</p>	<p>The policy on the Environmental Health designated reserve that will be in place by July 2009 will include a process to perform a yearly reconciliation of fee revenue going to the designated fund balance to identify and explain any discrepancies.</p>

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