

City of Houston, Texas

Report to Management for the
Year Ended June 30, 2011

December 2, 2011

City of Houston, Texas
901 Bagby
Houston, TX 77002

In planning and performing our audit of the financial statements of the City of Houston, Texas (the "City") as of and for the year ended June 30, 2011 (on which we have issued our report dated December 2, 2011), in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified, and included in the attached Appendix, certain deficiencies related to the City's internal control over financial reporting as of June 30, 2011, that we wish to bring to your attention.

The definitions of control deficiencies are also set forth in the attached Appendix.

This report is intended solely for the information and use of the Mayor, Members of City Council, the City Controller, management, and others within the organization and is not intended to be, and should not be, used by anyone other than these specified parties.

Yours truly,

Deloitte & Touche LLP

SECTION I — CONTROL DEFICIENCIES

We identified, and have included below, control deficiencies involving the City's internal control over financial reporting for the year ended June 30, 2011, that we wish to bring to your attention:

A. RECONCILIATION AND REVIEW OF BALANCE SHEET ACCOUNTS

The City does not regularly reconcile and review all accounts receivable accounts. The lack of timely reconciliations and reviews led to an adjustment in the classification of receivables.

The allowance for doubtful accounts related to certain accounts receivable was determined based on old historical collection data that had been carried forward for several years. The City should establish policies and procedures for calculating the allowances based upon historical experience, taking into consideration collections in recent years.

The City does not perform consistent reconciliation and review procedures related to all liability accounts. The lack of reconciliation and review led to the understatement of accounts payable in a certain fund.

B. WORKING TRIAL BALANCES

The City prepares its working trial balances based on a period 12 soft-close. A significant number of adjustments were still required to be posted to the working trial balances after the soft-close. The City should review its year-end closing process and evaluate the adjustments posted after the period 12 soft-close to determine the cause of such adjustments and if such adjustments can be processed prior to the period 12 soft-close. In addition, the City should ensure that the working trial balances are closed in a more timely manner.

C. FIXED ASSETS

The City continued to improve upon the understanding and usage of the fixed asset system and subledger during fiscal year 2011. Although the City performs reconciliations and reviews annually, these reconciliations and reviews should be performed more frequently. The lack of frequent reconciliations and reviews caused multiple material revisions of such rollforwards during the audit. Multiple revisions were due in part to the following:

- Late transfers of completed projects out of work in process (WIP)
- Inaccurate descriptions of assets

D. RELATED-PARTY TRANSACTIONS

The City requires certain employees to complete a conflict of interest statement; however, it does not appear that the City is tracking such related-party transactions to determine whether there would be any required disclosure in the City's annual financial report. The City should track related-party transactions for disclosure purposes.

E. COMPENSATED ABSENCES

The compensated absences liability report erroneously excluded a liability related to withdrawn employees. The report was revised to include the consideration of withdrawn employees in the determination of the compensated absences liability. However, the revised report still included various known immaterial errors. The City should increase efforts to review the liability report to ensure that it is accurate and complete. In addition, the estimate of the compensated absences liability expected to be paid out during the 2012 fiscal year should be refined to include all compensable absence types and only include the estimate of payments of compensated absences accrued as of fiscal year end.

F. DEBT

The City generally records adjustments to debt during the period 12 soft-close. However, there was a delay in recording these adjustments, and many of them were not recorded until after the end of the period 12 soft-close. Additionally, the City utilizes numerous spreadsheets to support debt adjustments and footnote disclosures. As a result of the delay in recording adjustments, there was a lack of timely and effective review of these spreadsheets and the general ledger, which resulted in audit adjustments and revisions to the debt rollforwards, supporting schedules and footnote disclosures.

G. SCHEDULE OF FEDERAL AND STATE AWARDS

The City did not properly account for certain grants that it received which resulted in the initial draft of the Schedule of Federal and State Awards ("SEFA") to be misstated. The SEFA was subsequently corrected for this issue. Particular attention should be paid to accounting for grants with matching requirements.

H. INFORMATION SECURITY

During our review of information security within the City, we noted the following observations.

Network password parameters

- The minimum password length for IT Domain is set to five characters. We recommend that passwords should be set to minimum password length of six characters or more.
- Maximum password age is set to expire after 180 days. We recommend that passwords should be set to a maximum password age of 90 days or fewer.

Data Center Access

- Public Works
 - During our review of the Data Center access report, we noted five terminated employees that had active access to data center. In addition, we noted a user access review was not performed for fiscal year 2011.
- Municipal Courts

- During our review, we noted a formal user access review for the Municipal Courts Data Center is not currently performed, but an excel spreadsheet is maintained to monitor list of individuals with access to Data Center. We recommend that a formal user access review be performed.
- Information Technology Department
 - D&T noted a formal user access review for the Houston Emergency Center (HEC) - Data Center is not currently defined or performed. We recommend that a user access review be defined and then performed.

CourtView Application

- While an application password is required to gaining access to the CourtView application, the password settings (password complexity, minimum password change interval, account lockout policy, etc.) are not available to be set within the CourtView application.

SECTION II — DEFINITIONS

The definitions of a deficiency, a material weakness, and a significant deficiency that are established in AU 325, *Communicating Internal Control Related Matters Identified in an Audit*, are as follows:

A *deficiency* in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A deficiency in design exists when (a) control necessary to meet the control objective is missing; or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when (a) properly designed control does not operate as designed; or (b) the person performing the control does not possess the necessary authority or competence to perform the control effectively.

A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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