

OFFICE OF THE CITY CONTROLLER



**SPECIAL REVENUE FUNDS
PERFORMANCE/COMPLIANCE AUDIT**

FOR FUNDS

**HOUSTON FOUNDATION
AND
REGIONAL PARTICIPATION**

Chris B. Brown, City Controller

Courtney E. Smith, City Auditor



OFFICE OF THE CITY CONTROLLER
CITY OF HOUSTON
TEXAS

CHRIS B. BROWN

September 27, 2019

The Honorable Sylvester Turner, Mayor
City of Houston, Texas

**SUBJECT: REPORT #2020-03 CITY-WIDE SPECIAL REVENUE FUND PERFORMANCE AUDIT –
FINANCE DEPARTMENT**

Mayor Turner:

The Office of the City Controller's Audit Division has completed a performance audit of two Special Revenue funds operated by the Finance Department:

- Houston Foundation
- Regional Participation

The purpose of the audit was to review the processes used to establish and operate special revenue funds and to evaluate the established fund's compliance with applicable policies, procedures, and regulatory guidance, and include a review and analysis of expenditures.

Based on work performed, we concluded that the processes used to establish the revenue funds were considered sufficient. As detailed in our report, those procedures also revealed certain findings regarding the operations and classification of the funds, that we considered necessary to be brought to the attention of those charged with governance.

We would like to express our appreciation to the management and staff of the Finance Department for their time and effort, responsiveness, and cooperation during this audit.

Respectfully submitted,

Chris B. Brown
City Controller

xc: City Council Members
Tantri Emo, Chief Business Officer/Director, Finance Department
Marvalette Hunter, Chief of Staff, Mayor's Office
Harry Hayes, Chief Operations Officer, Mayor's Office
Arif Rasheed, Deputy Director, Finance Department
Beverly Riggans, Interim Deputy City Controller, Office of the City Controller
Shannan Nobles, Chief Deputy City Controller, Office of the City Controller
Courtney Smith, City Auditor, Office of the City Controller

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EXECUTIVE SUMMARY

INTRODUCTION

The Audit Division (AD) of the City Controller’s Office has completed a performance audit of two special revenue funds operated by the Finance Department (FIN); Fund 2412 Houston Foundation and Fund 2425 Regional Participation. The audit was included as part of AD’s review of the City-wide Special Revenue Funds as outlined in the Fiscal Year 2018 Annual Audit Plan. The purpose of the audit was to review the processes used to establish and operate special revenue funds and to evaluate the established fund’s compliance with the applicable policies, procedures, and regulatory guidance, and include a review and analysis of expenditures.

BACKGROUND

The City has identified 77 Special Revenue funds which are classified as budgeted or non-budgeted however, not all of these funds are active. These funds are aggregated and reported in the Comprehensive Annual Financial Report as Nonmajor Governmental Funds, in the Basic Financial Statements. Grant funds are not considered Special Revenue funds and are not included as part of the 77 identified funds.

The creation and recording of revenue into a Special Revenue fund is dependent upon approval by the City Council. The process begins when the initiating department completes a Funds Management Master Maintenance Request form with supporting documentation and submits it to the Finance Department for review and approval. The application is also provided to the Financial Reporting Section of the Controller’s Office for review and approval, after which the approved application is forwarded to the SAP/ERP team at Houston Information Technology Service (HITS) for set-up in SAP.

We performed a risk assessment process on each of the 77 funds to determine funds to be selected for our audit. The details of the risk assessment procedures performed are presented below under the section “Risk Assessment and the Basis of Selection”.

SPECIAL REVENUE FUNDS DEFINED

The use and operation of Special Revenue Funds is governed by the Governmental Accounting Standards Board (GASB) Statement No. 54 (GASB 54). Per the provisions of Section 30 of GASB 54; “Special revenue funds are used to account for and report the proceeds of specific revenue sources that are restricted or committed to expenditure for specified purposes other than debt service or capital projects”. “The term *proceeds of specific revenue sources* establish that one or more specific restricted or committed revenues should be the foundation for a special revenue fund.” The Statement further states, “Special revenue funds should not be used to account for resources held in trust for individuals, private organizations, or other governments.”



Per GASB 54, the conditions upon which resources shall be classified as special revenue is based primarily upon whether they are restricted or committed. Restricted resources are funds that have been provided by creditors (bond sales), grantors, or donors or fund sources allowed through enabling legislation. As a result, restricted funds refer to resources that can be spent towards the specific purpose stipulated by constitution, external resource providers, or through enabling legislation. Committed funds are resources that can be used for the purposes determined by a formal action of the government's highest level of decision-making authority.

The requirements of GASB 54 were effective for financial statements for periods beginning after June 15, 2010 with early implementation encouraged. We acknowledge that the creation of many of the Special Revenue Funds predates the implementation and requirements of GASB 54; however, based on audit procedures performed we found no evidence to support that necessary procedures were performed subsequent to the issuance of the Statement to ensure that the classification and designation of Special Revenue Fund accounts maintained by the City were in accordance with the requirements of GASB 54.

RISK ASSESSMENT AND THE BASIS OF SELECTION

To determine the special revenue funds to be selected for our audit, we performed a risk assessment of all the City's 77 special revenue funds. The criteria used in the risk assessment are as detailed below:

- (a) Major funds determination: Any fund whose revenues constituted 10% or more of the aggregated total revenues of all special revenue funds was considered a major fund and as a result was considered high risk;
- (b) A 10% Plus or Minus Change in Revenue: A 10% positive or negative change in revenue over that of the prior year was considered as high risk;
- (c) Closed Accounts: Special revenue accounts closed during the period under audit were considered high risk;
- (d) New accounts opened: New special revenue fund accounts opened during the period were considered high risk;
- (e) Recent audit and audit adjustments: Where the funds have been subjected to recent audits either by the internal auditors, external auditors and/or monitoring agencies and there were audit adjustments arising from the audit engagement, the fund(s) were considered high risk;
- (f) Special designation: A fund was considered a high risk if it was designated or established through special provisions of the law, council decision or Mayor's directive.

Based upon the application of the risk assessment criteria, eight (8) special revenue funds across four (4) City departments were selected as shown in Table 1:



TABLE 1: FUNDS SELECTED

| S/N | Department | Fund(s) Selected | Account Number |
|------------|---|---|-----------------------|
| 1 | Administration and Regulatory Affairs (ARA) | (a) Parking Management | 8700 |
| | | (b) Ann Young BARC | 2426 |
| 2 | Finance (FIN) | (a) Houston Foundation | 2412 |
| | | (b) Regional Participation | 2425 |
| 3 | Planning and Development Department (PD) | (a) Planning and Development Fund | 2802 |
| 4 | Houston Public Works Department (HPW) | (a) Building Inspection | 2301 |
| | | (b) Dedicated Drainage and Street Renewal | 2310 |
| | | (c) Development Drainage Impact Fee | 2344 |

This report is intended to cover the two (2) special revenue funds under the control and oversight of FIN selected as samples for the purpose of achieving the audit objectives is contained in this report under the section “Audit Scope and Objective”. In addition, this report will provide detailed instances



of exceptions and findings noted in our audits of other special revenue funds administered by other City Departments considered to be under the purview and oversight of FIN.

DESCRIPTION OF SELECTED FUNDS MANAGED BY FIN

FIN currently administers both the Houston Foundation Fund and the Regional Participation Fund. They also perform other functions regarding funds administered by other departments, such as the creation of general ledger accounts in the accounting system and participation in the indirect cost allocation process. Other functions under the direct responsibility of FIN include budgeting, CIP, disaster recovery, procurement and financial reporting. For our audit, the under listed funds were selected upon application of our risk assessment criteria.

HOUSTON FOUNDATION (FUND No. 2412)

The Houston Foundation was created by City ordinance on March 22, 1915 as a general-purpose charity trust and is administered by an outside board of directors. Directors are nominated by the Mayor and approved by the City Council. The board of directors meet six times annually to review the status of the fund and review applications for assistance as well as approve fund distributions. The City's Finance Director serves as the Treasurer of the Board in accordance with the ordinance.

Fund revenue consists of investment income from various investments including dividend income, mineral income and interest income, however revenue is not derived through fundraising activities.

Distributions from the fund may be made for humanitarian needs of the people of Houston in the following categories:

- Care of dependent and helpless children;
- Nursing the sick;
- Free bureau for securing employment;
- Humane treatment of children and animals; and
- Bureau for social service information.

The Houston Foundation relies on eligible 501(c)(3) organizations to serve humanitarian needs. Interested organizations file an application for funding with the board of directors who then notifies applicants of funding decisions. Upon approval by the board, the applicant receives an award letter along with a check for the approved funding amount. After one year, the applicant is required to provide a report specifying how the funds were used.

Houston Foundation Fund assets for fiscal years ended June 30, 2015 through 2017 were as follows:



| TABLE 2 | | |
|--------------------------------|--------------|--------------|
| Houston Foundation Fund Assets | | |
| 2015 | 2016 | 2017 |
| 3,574,504.01 | 3,624,134.95 | 3,837,643.63 |

REGIONAL PARTICIPATION (FUND NO. 2425)

In 2007, the City and The Woodlands Township (Township), previously known as Town Center Improvement District of Montgomery County, entered into a Regional Participation Agreement as authorized by Texas Local Government Code, Chapter 43, Section 43.0754. According to the Request for Council Action (RCA) dated October 19, 2007, the Regional Participation agreement would establish a better, more cost effective and more efficient governmental relationship between the two communities. In addition, the Township benefits from the City’s highways, transportation systems, air and sea ports, the Texas Medical Center, employment centers as well as museum and arts facilities, while the City benefits from the Township’s business and economic advantages, housing, entertainment and lifestyle choices that the Township brings.

Terms of the agreement include, but are not limited to:

- The City agrees not to annex the area of the Woodlands for 50 years, although it is primarily located within the extraterritorial jurisdiction of the City.
- The Woodlands Township would provide funding to a segregated fund managed by the City for regional projects as specified in the agreement. Projects are selected by the City with consultation with the District and include projects such as improvements to major regional parks, access management projects for portions of the Hardy Toll Road, mobility improvements around the Texas Medical Center, open space regional water and wastewater projects, drainage and flood control and public safety among others.

This funding would be derived first from a \$16 million deposit from Township and subsequently from a portion of the Township’s sales and use tax revenue in the amount of 1/16 of 1 percent.

Quarterly reports are prepared by Township staff with supporting documentation based on sales tax allocation reports produced by the State Comptroller’s Office. Funds are deposited into the City’s account by wire transfer in conjunction with submittal of the reports.

FINANCIAL PERFORMANCE: HOUSTON FOUNDATION

For the audit, transactions for the fiscal years ended June 30, 2015, 2016 and 2017 were examined. Table 3 below shows the amounts recorded in SAP as revenue for the Houston Foundation for the scope period. The entries represent the summarized value of all investment account activity including income, disbursements, bank fees, and securities purchases and sales for the respective fiscal years.

Office of the City Controller



We noted no entries were recorded in SAP for fiscal year 2016. Testwork revealed that entries to record the transactions were submitted by FIN to the Controller’s Office, however, we noted no evidence to support that it was recorded in the CAFR.

| TABLE 3 | | | | |
|--|------------------------------|------------------|----------|-------------------|
| Houston Foundation Special Revenue Fund – Revenues for FYs 2015-2017 | | | | |
| Fund No. | Name | 2015 | 2016 | 2017 |
| 2412 | Interest/Investment Income | - | - | 263,139.62 |
| 2412 | Non-operating/Misc. Revenues | 40,661.00 | - | - |
| | Total Revenue | 40,661.00 | - | 263,139.62 |

Expenditures/disbursements are not recorded separately in SAP, however, distributions from the fund were made and the details are manually recorded in a spreadsheet maintained by FIN. Based on checking account statements, the amount of distributions made during the audit period are shown in Table 4 below.

| TABLE 4 | | | |
|---|------------|------------|------------|
| Houston Foundation Special Revenue Fund – Distributions for FYs 2015-2017 | | | |
| Fund No. | 2015 | 2016 | 2017 |
| 2412 | 107,500.00 | 138,500.00 | 183,350.00 |

FINANCIAL PERFORMANCE: REGIONAL PARTICIPATION

Transactions were examined for fiscal years ended June 30, 2015, 2016 and 2017. The following table lists the revenue receipts for the Regional Participation fund for these fiscal years:

| TABLE 5 | | | | |
|--|----------------------------|---------------------|---------------------|---------------------|
| Regional Participation Fund Revenues for FYs 2015-2017 | | | | |
| Fund No. | Name | 2015 | 2016 | 2017 |
| 2425 | Intergovernmental | 1,545,295.00 | 1,571,473.00 | 1,595,892.00 |
| 2425 | Interest/Investment Income | 52,418.88 | 105,452.03 | 33,400.19 |
| | Total Revenues | 1,597,713.88 | 1,676,925.03 | 1,629,292.19 |



Regional Participation fund proceeds were expended for FYs 2015-2017 as shown in Table 5 below:

| TABLE 6 | | | | |
|--|----------------------------|-------------------|------------------|---------------------|
| Regional Participation Fund Expenditures for FYs 2015-2017 | | | | |
| Fund No. | Name | 2015 | 2016 | 2017 |
| 2425 | Other Services and Charges | 623,079.45 | 16,230.81 | 1,194,370.83 |
| | Total | 623,079.45 | 16,230.81 | 1,194,370.83 |

AUDIT SCOPE AND OBJECTIVES

The primary objectives of the audit are to:

- Review the processes used to establish the special revenue fund. (**Objective #1**)
- Review processes used to operate the special revenue fund and evaluate the established fund’s compliance with the applicable policies, procedures, and regulatory guidance, and include a review and analysis of expenditures. (**Objective #2**)

The engagement scope included operations and transactions occurring in Fiscal Years 2015, 2016 and 2017.

PROCEDURES PERFORMED

To obtain sufficient evidence to achieve engagement objectives and support our conclusions, we performed the following steps:

- Reviewed authoritative literature related to special revenue governmental funds;
- Obtained and reviewed enabling legislation (ordinances) that created the fund(s);
- Obtained and reviewed documentation supporting the rationale for the funds’ creation where applicable;
- Performed a risk assessment to determine funds to be selected for audit;
- Performed analytical reviews of revenues and expenditures;
- Inquired regarding processes used to create and operate special revenue funds in SAP;
- Obtained payroll data for special revenue funds that support staff;
- Performed testing of transactional detail for revenues, payroll, transfer and other expenditures;
- Reviewed CAFR as prepared by the Office of the City Controller to determine how special revenue funds were presented for external purposes; and



-
- Reviewed Monthly Financial Statements as prepared by the Finance Department and the Office of the City Controller, where available as well as selected City Council minutes as a basis for assessing council oversight of funds.

AUDIT METHODOLOGY

We conducted this performance and compliance audit in accordance with Generally Accepted Government Auditing Standards and in conformance with the International Standards for the Professional Practice of Internal Auditing. Those standards require that we plan and perform the audit to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The scope of our work did not constitute an evaluation of the overall internal control structure of the City or the Finance Department. Management is responsible for establishing and maintaining a system of internal controls to ensure that City assets are safeguarded; financial activity is accurately reported and reliable; and management and employees are in compliance with laws, regulations, and policies and procedures. The objectives are to provide management with reasonable, but not absolute assurance that the controls are in place and effective.

CONCLUSIONS AND SIGNIFICANT ISSUES

We believe that we have obtained sufficient and appropriate evidence to adequately support the conclusions provided below as required by professional auditing standards. Each Conclusion is aligned with the related Audit Objective for consistency and reference. For detailed findings, recommendations, management responses, comments and assessment of responses, see the “Detailed Findings, Recommendations, Management Responses, and Assessment of Responses” section of this report.

CONCLUSION 1 – (AUDIT OBJECTIVE #1)

Based on work performed, we conclude that the processes for the establishment, of the special revenue funds are considered adequate.

CONCLUSION 2 – (AUDIT OBJECTIVE #2) –

Based on work performed, we conclude that the processes of classification, designation and reporting used to operate the special revenue fund and evaluate the fund’s compliance with the requirements of GASB 54 are considered inadequate. See Findings 1 through 3 in the Section “Detailed Findings, Recommendations, Management Responses and Assessment of Responses”.




ACKNOWLEDGEMENT AND SIGNATURES

The Audit Team would like to thank the management and staff of the Finance Department for their cooperation, time and efforts throughout the course of the engagement.



Olaniyi Oyedele, CPA
Audit Manager



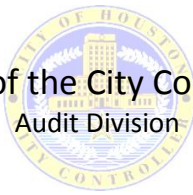
Courtney E. Smith, CPA, CIA, CFE
City Auditor



DETAILED FINDINGS, RECOMMENDATIONS, MANAGEMENT RESPONSES, AND ASSESSMENT OF RESPONSES**FINDING #1 – FUNDS IMPROPERLY CLASSIFIED AS SPECIAL REVENUE FUNDS
RISK RATING (IMPACT AND MAGNITUDE) = HIGH****BACKGROUND:**

Per Paragraph 30 of the provisions of Statement No. 54 of the Governmental Accounting Standards Board (GASB) *Fund Balance Reporting and Governmental Fund Type Definitions*; “Special revenue funds are used to account for and report the proceeds of specific revenue sources that are restricted or committed to expenditure for specified purposes other than debt service or capital projects. The term *proceeds of specific revenue sources* establish that one or more specific restricted or committed revenues should be the foundation for a special revenue fund. Those specific restricted or committed revenues may be initially received in another fund and subsequently distributed to a special revenue fund. Those amounts should not be recognized as revenue in the fund initially receiving them; however, those inflows should be recognized as revenue in the special revenue fund in which they will be expended in accordance with specified purposes. Special revenue funds should not be used to account for resources held in trust for individuals, private organizations, or other governments”. While the charter is silent regarding non-budgeted funds, Article III, Division 1, Section 2-54 of the City charter, the Finance Department is responsible for establishing a system of management reporting for budgeted funds and would in our estimation be in the best position to manage reporting of non-budgeted funds.

During the audit, we performed procedures to determine whether the special revenues funds were appropriately classified in the Comprehensive Annual Financial Report (CAFR) in accordance with the requirements of GASB 54. To achieve this objective, we obtained the balance of revenues reported in the special revenue funds (SRFs) for Fiscal Years 2015 and 2016 respectively, from SAP, and compared them with the balance of SRFs contained in the CAFR for the same fiscal years. Based on the risk determination criteria applied on the City’s 77 funds identified as special revenue funds, we selected eight (8) funds and performed procedures to ascertain whether they were properly classified, and whether their manner of operations regarding the use of committed or restricted resources for specified purposes were in accordance with the provisions of GASB 54.



FINDING:

We noted two (2) instances where funds have been classified and/or designated as special revenue funds contradictory to the requirements of GASB 54. Such instances include:

- (a) **The Houston Foundation:** The Houston Foundation (the “Foundation”) was created through a City Ordinance dated March 22, 1915. The fund was established as a trust fund but has not been reviewed since the implementation of GASB 54. According to the provisions of Section 4(b) of the Ordinance, the fund was established to “faithfully execute the wishes of any donors of such trust estates, whether such trust estates arise from gifts, devises or bequests, and covert, invest, re-invest and the corpus and income from such estate, or estates as directed in the instrument or instruments creating the same, and if there be no such specific directions, then in manner herein provided”. Furthermore Section 4(c) provides that “the aggregate of the gifts, devises or bequests to the City of Houston for charitable, benevolent or public welfare uses shall constitute and be known as the Houston Foundation. The Foundation received monies from the E.P. Hill and H.P. Bering bequests and trusts respectively. Audit procedures performed revealed that the fund was classified both in SAP and the CAFR as a special revenue fund contrary to the provisions of GASB 54.

- (b) **The Ann Young BARC Fund:** In 2007, a citizen; Ann Slemons Young in her final will dated January 13, 2007, and acting through the Ann Slemons Foundation (ASF), a charitable trust created pursuant to the terms of her will, bequeathed to the City property from her residuary estate. According to the terms and conditions contained in the will; “ASF shall exist and the properties of ASF shall be used, exclusively, and solely, for the support of the City of Houston, Bureau of Animal Regulation and Control (BARC)”. In November 2009, proceeds from the closure of the estate amounting to approximately \$2M was received by the City and a special revenue fund account was created to hold resources from the estate. However, in 2013, following issues arising from the implementation of the conditions contained in the will which the city management considered too stringent, the fund proceeds were rejected, and the money was returned.

RECOMMENDATION:

We recommend that:

- (a) A comprehensive review of the city’s funds be carried out to ensure they are properly classified and designated in accordance with the provisions of GASB 54 to facilitate
-

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proper representation and presentation in the CAFR.

- (b) A training session should be organized by the Finance Department, Controller's Office in conjunction with the Learning and Development Center (LDC) for the appropriate city accounting and finance personnel on the requirements of GASB 54 and its accounting implications. An outside consultant/trainer may be engaged to lead the training to provide objectivity and adequate technical support.

FINANCE DEPARTMENT MANAGEMENT

RESPONSE:

This recommendation should be directed to Controller's Office – FR. We will work with Controller's Office to appropriately reclassify the Fund in SAP.

OFFICE OF THE CONTROLLER'S DEPARTMENT MANAGEMENT

RESPONSE:

The Financial Reporting Division of the Office of the Controller will work with Finance Department to reclassify any funds.

RESPONSIBLE PARTY:

The responsible parties include Finance Department and the Controller's Office.

ESTIMATED DATE OF COMPLETION:

June 30, 2020

ASSESSMENT OF

RESPONSE:

Management responses including procedures enumerated for corrective action are considered adequate in addressing the finding identified.



FINDING #2 – NO FORMAL WRITTEN POLICIES AND PROCEDURES TO GUIDE DESIGNATION AND CLASSIFICATION OF FUNDS

RISK RATING (IMPACT AND MAGNITUDE) = HIGH

BACKGROUND:

The process for establishing whether a special revenue fund is in accordance with the requirements of GASB 54 depend primarily upon whether the resources of the fund are *restricted or committed*. Paragraph 8 of GASB 54 provides that fund balance should be reported as restricted when constraints placed on the use of the resources are either:

- (a) Externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other government; or
- (b) Imposed by law through constitutional provisions or enabling legislation

Similarly, Paragraph 10 of GASB 54 provides that committed fund balance represent amount that can only be used for specific purposes pursuant to the constraints imposed by the formal action of the government’s highest level of decision-making authority.

During the audit we performed procedures to determine whether the special revenue funds selected for the audit were established, classified and presented in accordance with the requirements of GASB 54.

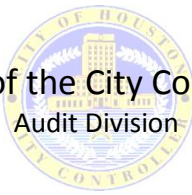
FINDING:

Audit procedures performed revealed there is no formal written procedures for determining whether a fund is designated a special revenue fund in accordance with the requirements of GASB 54. This is also primarily responsible for the exceptions noted in Finding #1 contained in this report. According to Government Finance Officers Association (GFOA) “Financial policies are central to a strategic, long-term approach to financial management. Some of the most powerful arguments in favor of adopting formal, written financial policies include their ability to help governments; institutionalize good financial management practices. Formal policies usually outlive their creator, and, thus promote stability and continuity. They also prevent the need to re-invent responses to recurring issues. Financial policies define limits on the actions staff may take. The policy framework provides the boundaries within which staff can innovate in order to realize the organization’s strategic intent.

RECOMMENDATION:

We recommend that a formal policy and procedure manual be adopted for determining the establishment, designation and classification of a special revenue fund in accordance with the requirements of GASB 54. This can:

Office of the City Controller



-
- (a) Ensure accounts, transactions and general ledger are properly designated and appropriately classified as special revenue funds in accordance with GASB standards.
 - (b) Reduce and possibly eliminate arbitrary classification of accounts as special revenue funds solely based on faulty or incomplete knowledge and/or interpretation.
 - (c) Ensure consistency in the classification and designation of accounts as special revenue funds.

To address the above recommendations, we suggest that initial efforts should be geared towards reviewing existing policy and procedures relating to account codes, and grouping to assess its inadequacies in the proper designation and classification of special revenue funds for presentation in the CAFR. Personnel from city departments such as Finance, Controller's Office, IT SAP/ERP, should be involved in this process.

**FINANCE DEPARTMENT MANAGEMENT
RESPONSE:**

The City's financial policies are reviewed every two years for potential necessary updates. The next update is anticipated in Spring 2020. Following the update of the financial policies, which are high-level, procedures will need to be drafted and finalized in accordance with GASB Standards. We will work with Controller's office and HITS-ERP to evaluate and update related procedures as necessary.

RESPONSIBLE PARTY:

The responsible parties include Finance Department and other departments with responsibilities / roles to play in the update process.

ESTIMATED DATE OF COMPLETION:

Fall 2020

**ASSESSMENT OF
RESPONSE:**

Management responses including procedures enumerated for corrective action are considered adequate in addressing the finding identified.



**FINDING #3 –TRANSACTIONS NOT INCLUDED IN SAP AND INCOMPLETE MONTHLY FINANCIAL REPORTS
PRESENTED TO THE CITY COUNCIL**

RISK RATING (IMPACT AND MAGNITUDE) = HIGH

BACKGROUND:

Governmental Accounting Standards Board (GASB) Concepts Statement No 1, (the “Statement”) *Objectives of Financial Reporting* provides that “governmental financial reporting objectives are influenced by the characteristics of the state and local governmental operating environment and by the needs of those who use governmental financial reports”. According to the Statement, during establishing financial reporting objectives, there are significant characteristics of the governmental environment that need to be considered, one of which is control characteristics. According to the Statement, control characteristics resulting from government’s structure involve:

- (a) The budget as an expression of the public policy and financial intent and as a method of providing control
- (b) The use of fund accounting for control purposes

The City’s government structure control characteristics include a budget process and the use of fund accounting for financial reporting and internal control purposes.

Paragraph 64 of the Statement provides that “financial reporting should be reliable; that is, information presented should be verifiable and free from bias and faithfully represent what it purports to represent. To be reliable, financial reporting needs to be comprehensive. Nothing material should be omitted from the information necessary to faithfully represent the underlying events and conditions, nor should anything be included that would cause the information to be misleading”.

City Council (the “Council”) as the elected representatives of the citizens provides the necessary oversight over the generation of the public funds and the purpose to which those funds are committed. As part of its oversight responsibilities, the Council as a governing body, must have access to periodic operational activities of all funds maintained by the City including those for which it maintains fiduciary responsibility.

During the audit, we reviewed the process for presenting the financial reports to the Council. We selected a sample of months for each of the funds under audit. We obtained the Monthly Financial Reports (MOFR) and obtained the minutes for the Council for the months selected to ascertain whether the funds were included in the MOFR presented to the Council. The MOFR is a joint responsibility of Finance Department and the Office of the Controller’s Department.



FINDING:

Audit procedures performed revealed the following exceptions:

- (a) The financial statements for the Regional Participation Fund (2425) for the month of June 30, 2017 which had a trial balance in the amount of \$24,220,081.22 was not included in the MOFR presented to the Council.
- (b) Detailed transactions of the Houston Foundation involving receipts and monies disbursed in operations were not recorded in SAP, instead, the net increase/decrease in balance was recorded in SAP for the year ended June 30, 2017, as a journal entry.

Audit procedures also revealed that monthly financial reports for several other non-budgeted special revenue funds were also not presented and nor disclosed in notes in the MOFR. The implications of this are:

- (i) Monthly Financial Reports may be incomplete and not fully representative of the results of operations.
- (ii) Monthly Financial Reports are not presented in accordance with the generally accepted accounting principles which require that financial reports be prepared under the principles of completeness, consistency and materiality.

RECOMMENDATION:

The administration should seek to present monthly financial statements for all funds for which it has responsibility to ensure the reliability and completeness of information presented to the Council for review and approval in accordance with accounting concepts and principles. In cases where several funds have minimal balances or activity, they can be aggregated and reported as one with a disclosure note identifying which funds they represent. In the alternative, if certain funds will not be presented, there should be a disclosure as to which funds they are, the aggregate balance at month end and a disclosure note explaining why they are not presented.

For the Houston Foundation, consideration should be given to recording income and distribution transactions in SAP monthly by journal entry if necessary. This would assure detail transactions are recorded and would disclose errors or irregularities in a timely manner in the City's reporting system. It would also create a historical record in one place without having to refer to spreadsheets (which can be easily manipulated), or to bank statements, canceled checks or board minutes which require manual review.



**FINANCE DEPARTMENT MANAGEMENT
RESPONSE:**

The Administration will collaborate with the Controller's Office to modify the Monthly Financial Report to address funds not currently presented to Council.

Finance will record income and distribution transaction related to Houston Foundation Trust Fund in SAP on a monthly basis.

**OFFICE OF CONTROLLER'S DEPARTMENT MANAGEMENT
RESPONSE:**

Financial Reporting agrees that all Special Revenue Funds should be presented in the MFOR. Funds without a budget can be shown as a disclosure as recommended by the Audit Division.

All transactions for the Houston Foundation should be booked in SAP.

RESPONSIBLE PARTY:

The responsible parties include the Finance Department (FIN) and the Office of the Controller's Department (Financial Reporting).

ESTIMATED DATE OF COMPLETION:

June 2020

**ASSESSMENT OF
RESPONSE:**

Management responses including procedures enumerated for corrective action are considered adequate in addressing the finding identified.



APPENDIX 1

LIST OF SPECIAL REVENUE FUNDS

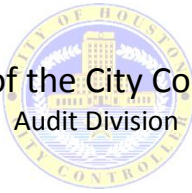
I. BUDGETED

| Serial No | Fund Account No | Name |
|-----------|-----------------|--------------------------------|
| 1. | 2002 | Health Special |
| 2. | 2008 | Laboratory Svcs |
| 3. | 2009 | Swimming Pool Safety |
| 4. | 2010 | Essent Pub Hlth Svcs |
| 5. | 2100 | Park Special Rev. |
| 6. | 2104 | Parks Golf Special |
| 7. | 2106 | Bayou Greenway 2020 |
| 8. | 2200 | Auto Dealers |
| 9. | 2201 | Police Special Svcs |
| 10. | 2202 | Asset Forfeiture - Treasury |
| 11. | 2203 | Asset Forfeiture - Justice |
| 12. | 2204 | Asset Forfeiture - State |
| 13. | 2205 | Houston Emergency Center |
| 14. | 2207 | Municipal Court Technology |
| 15. | 2209 | Child Safety Fund |
| 16. | 2210 | FTA Special Revenue |
| 17. | 2211 | Juvenile Case Manager Fee |
| 18. | 2301 | Building Inspection |
| 19. | 2305 | Recycling Revenue |
| 20. | 2306 | Historic Preservation |
| 21. | 2308 | P&DD Special Revenue |
| 22. | 2310 | DDSR |
| 23. | 2401 | Cable Television |
| 24. | 2402 | Houston Transtar |
| 25. | 2409 | TIRZ Affordable Housing |
| 26. | 2413 | John Battaglia Trust |
| 27. | 2423 | Special Waste |
| 28. | 2424 | Contractor Responsibility Fund |
| 29. | 2428 | State Cable TV |
| 30. | 8700 | Parking Management |
| 31. | 8700A | Parking Benefit Dist. |
| 32. | 2105 | Maintenance and Replacement |
| 33. | 2206 | Building Security |
| 34. | 2213 | Forensic Transition |
| 35. | 2302 | Stormwater Fund |
| 36. | 2427 | BARC Special Revenue |
| 37. | 2429 | Tourism Promotion |



LIST OF SPECIAL REVENUE FUNDS
II. NON-BUDGETED

| Serial No | Fund Account No | Name |
|-----------|-----------------|---------------------------------|
| 1. | 2000 | Housing Special Revenue |
| 2. | 2006 | Summer Youth Program |
| 3. | 2007 | REEP Program |
| 4. | 2020 | Comm Health & Assmt |
| 5. | 2102 | MacGregor Parks Endowment |
| 6. | 2103 | Parks Planting Tree |
| 7. | 2208 | Helmets Bicycles Safety |
| 8. | 2212 | Digital Automated Red Light |
| 9. | 2214 | Nuisance Abatement |
| 10. | 2304 | Mobility Response |
| 11. | 2344 | Development Drainage Impact Fee |
| 12. | 2400 | TIRZ Affordable Housing |
| 13. | 2403 | MNC Memorial City |
| 14. | 2404 | Supplementary Environment |
| 15. | 2405 | Neighborhood Project |
| 16. | 2407 | Misc. City Trust |
| 17. | 2408 | Misc. Gift trust |
| 18. | 2410 | Aff House Uptown 2002B |
| 19. | 2411 | W.A.T.E.R Fund |
| 20. | 2412 | Houston Foundation |
| 21. | 2416 | AffHousMidtownSer201 |
| 22. | 2417 | AffHousUptwnSer2004 |
| 23. | 2418 | AffHousUptwnSer2004D |
| 24. | 2419 | Disaster Recovery |
| 25. | 2420 | TIRZ2 AffHousMidtown |
| 26. | 2421 | Consumer Choice Init |
| 27. | 2422 | Digital Houston WIFI |
| 28. | 2425 | Regional Participation |
| 29. | 2426 | Ann Young BARC Special |
| 30. | 2500 | Library Special Revenue |
| 31. | 2004 | HJTPC Self-Insurance |
| 32. | 2303 | TxDOTSignalMaint |



LIST OF SPECIAL REVENUE FUNDS

III. NON-CLASSIFIED WITH ACTIVITY

| Serial No | Fund Account No | Name |
|-----------|-----------------|----------------------|
| 1. | 2101 | Operation Gang |
| 2. | 2105 | M.R.R Fund |
| 3. | 2300 | Sign Administration |
| 4. | 2406 | MarchofDimesHealthEd |
| 5. | 2414 | AAA ContingencyFund |
| 6. | 2415 | RentalRehabInsurance |
| 7. | 2900 | LegacyConverAsset |
| 8. | 2901 | LegacyClosedFund |



EXHIBIT 2

ACKNOWLEDGEMENT STATEMENTS

Acknowledgement Statement

Date: September 26, 2019

Chris B. Brown
City Controller
Office of the City Controller

**SUBJECT: CITY-WIDE SPECIAL REVENUE FUNDS PERFORMANCE AUDIT FOR FUNDS
FIN – FUND 2412 HOUSTON FOUNDATION
FIN – FUND 2425 REGIONAL PARTICIPATION**

ACKNOWLEDGEMENT OF MANAGEMENT RESPONSES

I acknowledge that the management responses contained in the above referenced report are those of the Finance Department. I also understand that this document will become a part of the final audit report that will be posted on the Controller's website.

Sincerely,

A handwritten signature in blue ink, appearing to read "Tantri Emo", written over a horizontal line.

Tantri Emo, Director
Finance Department

Acknowledgement Statement

Date: September 26, 2019

Chris B. Brown
City Controller
Office of the City Controller

**SUBJECT: CITY-WIDE SPECIAL REVENUE FUNDS PERFORMANCE AUDIT FOR FUNDS
FIN – FUND 2412 HOUSTON FOUNDATION
FIN – FUND 2425 REGIONAL PARTICIPATION**

ACKNOWLEDGEMENT OF MANAGEMENT RESPONSES

I acknowledge that the management responses contained in the above referenced report are those of the Financial Reporting Division. I also understand that this document will become a part of the final audit report that will be posted on the Controller's website.

Sincerely,

A handwritten signature in cursive script that reads "Beverly J. Riggans". The signature is written in dark ink and is positioned above a horizontal line.

Beverly J. Riggans, Interim Deputy City Controller
Office of the City Controller

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