



To Management of the City of Houston, Texas:

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Houston, Texas (the "City") for the year ended June 30, 2014, (on which we have issued our report dated November 21, 2014, which contains a reference to other auditors) in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) 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 over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

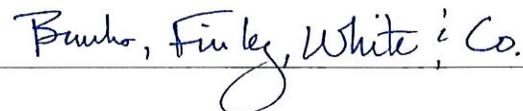
Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, in connection with our audit, we identified, and included in the following pages of this report, deficiencies related to the City's internal control over financial reporting as of June 30, 2014, that we wish to bring to your attention.

We have also issued a separate report to City Council and management, also dated November 21, 2014, which includes certain matters involving the City's internal control over financial reporting that we consider to be a material weakness under standards established by the American Institute of Certified Public Accountants.

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 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.

This report is intended solely for the information and use of the City's elected officials, management and others within the City and is not to be and should not be used by anyone other than these specified parties. We will be pleased to discuss these comments with you and, if desired, to assist you in implementing any of the suggestions.





November 21, 2014.

OTHER COMMENTS AND OBSERVATIONS

Analysis of General Ledger Accounts

In connection with our analysis of numerous balance sheet accounts, primarily in the areas of cash and accounts receivables, we noted numerous accounts where there was either no change or minimal change from the prior year's balances. Further inquiry regarding these accounts as part of our audit in these areas revealed that many of these accounts were carryover balances that had been in place prior to conversion to the current financial accounting system (SAP). Furthermore, it is our understanding that for some of these accounts that relate to old outstanding receivables remains in the City's accounting records because the State of Texas does not allow local governments to write-off receivable accounts.

The City maintains several "Not Reported" funds which are used to monitor activity on a memo basis for reconciling to applicable funds used in the financial reporting process. One such fund is the "Pool Cash Fund" which is used account for the City's concentration of cash balances across all participating funds. The fund, however, is overstated by \$18 million due to several old accounts balances that are not reconcilable to cash accounts held by a bank in the City's name and to cash balances reported in the financial statements.

Recommendation

We recommend that the City make efforts to appropriately offset and eliminate old outstanding accounts against active SAP accounts where possible. For old receivable balances, while the State does not allow these balances to be written off, the City should re-evaluate the methodology of the allowance computation and adjust the allowance accounts to fully reflect the inability to collect of old outstanding accounts.

As for the Pool Cash Fund, we recommend that the City make the appropriate entries to bring the Pool Cash Fund in agreement with existing bank and cash account balances.

Monitoring of Component Unit Activity

Within the City's Comprehensive Annual Financial Report (CAFR), under generally accepted accounting principles, the City includes as part of its financial reporting entity the Houston Housing Finance Corporation (HHFC) as a discretely presented component unit. The overall nature of the activity of the HHFC appears to be inconsistent with the financial statements received from HHFC by the City and included in the CAFR. The statements used by the City only include reporting of the Cash Accounts of the HHFC and not that of the entire operation.

Recommendation

We would encourage the City to have discussions with the HHFC regarding obtaining financial statements that report on the entire activity of the organization.

Monitoring Service Provided by Outside Service Organization

The City uses outside service organizations to perform various functions such as third party administration of various benefit plans. Using third parties to perform such services is customary within local government; however, the City remains responsible for ensuring that such entities have in place effective internal controls over account balances or transactions they are servicing for the City. To provide evidence of the existence of effective controls, these “service organizations” should provide customers an annual “service organization auditor’s report” (currently referred to as a SOC-1 Report). The report provides evidence by the service organization’s independent auditor of the testing of the effectiveness of appropriate controls. The report also stipulates that the effectiveness of the organization’s controls is dependent on the implementation of certain “user controls”. These controls represent the City’s responsibility in the use of service organizations.

During the course of our current year audit, we did not see evidence that the City is obtaining and reviewing the service organization reports on a timely basis. Additionally, we did not see evidence that the City has procedures in place to ensure “user controls” have been implemented on a timely basis. We were able to obtain and review the service organization reports as part of the audit process and determine that sufficient controls were in place at the service organization level and, at our request; the City was able to document proper implementation of user controls.

Recommendation

The City should develop procedures within affected departments that establish requirements for the receipt and documented review of service organization reports. These requirements should address the timing of the receipt of reports and the sufficiency of the audit scope for the City’s purposes. Additionally, the procedures should also set forth requirements for ensuring applicable user controls established by the service organizations are in place and implemented by the City.

Review of Information Technology Services Area

In connection with the audit and our review of internal control related to financial reporting, we noted the following items in the Houston Information Technology Services Department (HITS) of the City:

- HITS has a backup and data retention policy/schedule that specifies how and when backups are to be performed. Best practices stipulate that data and file recovery procedures be tested at least annually. Data from the backups is run on tapes and maintained in the same data center. We recommend that backup tapes be stored and retained offsite on a regular schedule. Additionally we did not see evidence that the backup tapes are being tested to ensure their completeness and usability. We recommend that procedures be developed and implemented to test backup tapes on a regular schedule.
- HITS does not have an enterprise level user access policy for users by role and position. We understand that HITS is developing an electronic interface between the Active Directory, which contains all user access information, and SAP role-based security. By interfacing these systems, the City would have an enterprise level user access policy. We recommend that the City continue to move forward with this approach.