OFFICE OF THE CITY CONTROLLER

FISCAL YEAR 2014

UPDATED AUDIT PLAN

Ronald C. Green, City Controller

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Report No. 2014-06

OFFICE OF THE CITY CONTROLLER
CITY OF HOUSTON
TEXAS

RONALD C. GREEN

November 26, 2013

The Honorable Annise D. Parker, Mayor
City Council Members
City of Houston, Texas

SUBJECT: Office of the City Controller
Updated Fiscal Year 2014 Audit Plan

Dear Mayor Parker and Council Members:

I am pleased to submit to you the Updated Fiscal Year 2014 Audit Plan. The basis of this year's Annual Audit Plan (Audit Plan) was an Enterprise Risk Assessment (ERA) performed by the Audit Division as required by the applicable professional auditing standards (ERA report to be issued under separate cover). Additional consideration is given to input from your offices and Department Directors. This document will serve as the primary work plan to carry out the audit responsibilities in an efficient and effective manner. To enhance our effectiveness, our approach is balanced by conducting the audits using, in-house staff and by co-sourcing or outsourcing some projects requiring certain technical or specialized skills.

This Audit Plan includes performance, compliance/contract, monitoring, continuous auditing, and unannounced audits. Additionally, the plan provides for follow-up procedures and special projects.

We post the status of progress in executing our audit plan on a quarterly basis on the Audit Division webpage within the Office of the City Controller website.

Respectfully submitted,

Ronald C. Green
City Controller

Xc: Waynette Chan, Chief of Staff, Mayor's Office
Andy Icken, Chief Development Officer, Mayor's Office
Department Directors

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BACKGROUND AND AUTHORITY –

The City Controller is an independently elected official who is granted the authority (through the City Charter, Article VIII, Section 7) to *"…. be responsible for conducting internal audits, in accordance with professionally recognized auditing standards, of the operations of all City departments, offices, agencies and programs. The scope of internal auditing shall encompass an objective and systematic examination of evidence to provide an independent assessment of the efficiency and effectiveness of the city's system of internal controls and the quality of performance based on quantifiable criteria in meeting objectives…."*. The City Controller assigns this responsibility to the City Auditor (through appointment) to be the executive in charge of the Audit Division, whose scope of work is contained under a separate Charter (Audit Division Charter). Audit results are issued to the Mayor, City Council Members and Department Directors.

AUDIT DIVISION ORGANIZATION –

During FY2013, the Audit Division had 2 staff retire, with both planned replacements and adding back one slot previously lost due to the downturn in the economy in 2010-2011, bringing the total headcount to 13, consisting of 11 professional Audit Staff, one support staff, and the City Auditor. The Audit Division has two primary sections, which consist of Audit and Information Technology (IT) Audit. Each section provides audit related services as their primary objective; however the IT Audit section is focused on Data Analysis as support for determining control risk around the key information systems, as well as the overall view of Information Technology throughout the organization. As we receive additional training, certifications, and experience, we will continue to increase our ability to provide enhanced and value-added services.

The Controller's Office utilizes internal and external audit resources to execute our mission and objectives and meet the needs and requests of our varied stakeholders. Additionally, we have 9 professional service firms under contract through March 15, 2014 with 2 (1) year renewal options.

APPROACH AND METHODOLOGY –

The Audit Division adheres to: 1) the *Government Auditing Standards* (GAS – commonly referred to as the "Yellowbook") as promulgated by the Government Accountability Office (GAO) and 2) the International Standards for the Professional Practice of Internal Auditing as issued by the Institute of Internal Auditors (IIA – known as the "Redbook"). To assure compliance with these professional standards, the Audit Division undergoes a peer review every 3 years.

The Annual Audit Plan is a *flexible* commitment of the Audit Division within the Office of the City Controller to perform engagement activity related to the responsibility and authority identified in the City Charter as quoted above. The Audit Plan, which is approved by the City Controller, serves as a working document that considers items such as; the Enterprise Risk Assessment (ERA), input from Mayor, City Council, Department Management, and results from previous audits, etc. Due to the continual requests for audit services, the increasing demand for non-audit services, and the required testing for planned activities, the Audit Plan will be monitored and revised as necessary throughout the year. To enhance communication and facilitate transparency, the City Auditor is presenting status and results to the Budget and Fiscal Affairs Committee semi-annually.

The professional standards noted previously require that the Audit Plan be rooted in risk-based methodology. Historically, the Audit Division had outsourced its risk assessment process to external consultants and utilized the results provided in a report to assist in developing the annual audit plan. The previous risk assessments had been performed in 1994, 1999, and 2004 respectively. In FY 2010, the Audit Division conducted the ERA internally and utilized approximately 3 full-time equivalents (FTEs). Since then, the ERA is being executed annually

on selected Departments on a rotational basis for efficiency and to ensure full coverage of all City Departments over a 4-5 year period[1].

Evaluating all of these various factors provides indicators on prioritizing the potential projects for the upcoming year. In other words, this points us in the direction of "*what"* to audit. We then identify the available resources to determine the volume of activity to include in our plan (see Audit Resource Allocation section below).

AUDIT RESOURCE ALLOCATION –

Annually, the Audit Plan prioritizes the Audit Division's limited resources of budgeted staff and funds based on the previously referenced risk assessment. The Audit Plan, therefore prioritizes expending efforts on either common Key Business Processes or Departments having a perceived high or moderate risk profile rating. As such, the City's audit function serves as a risk evaluation resource through the promoting and recommending the development of improved controls and the testing of existing controls.

The number of projects that are proposed is based on consideration and an evaluation of:

- Current headcount within the Audit Division;
- Average number of hours used on a typical audit engagement[2];
- Other types of ongoing services that the Controller's Office provides; and
- Unplanned requests from Mayor, City Council, or other Department Management,

USE OF EXTERNAL CONSULTANTS

For projects that involve circumstances where; 1) The use of experts/specialists is required; 2.) The independence of the Audit Division as an organization is impaired; or 3.) There is the potential for significant political sensitivity, the Office of the City Controller may elect to use external consultants. NOTE: A budgeted dollar amount is approved for the use of these resources.

AUDIT PROGRAMS –

Upon the City Controller's approval of the Audit Plan, specific audit programs will be developed for each activity to be audited within the fiscal year ending June 30, 2012. The audit programs will be designed with regard to business services, compliance and other requirements, performance considerations, management input, and specialized skills in order to meet the specific audit objectives of each project. All audit programs, workpapers, and reports will be prepared in accordance with:

- Relevant standards issued by the American Institute of Certified Public Accountants;
- Government Auditing Standards (*Yellow Book*); and
- The Institute of Internal Auditor's International Standards for the Practice of Internal Auditing (*Red Book*).

Where applicable, disclosure of nonconformance will be provided.

[1] See 12-02 FY2011 ERA Update under separate cover.

[2] The Audit Division is a member of the Association of Local Government Auditors (ALGA), which provides aggregated data on internal auditing for local governments, including resource utilization (average number of hours per project).

STATUS AND UPDATES TO ANNUAL AUDIT PLAN –
The specific projects conducted throughout the year may be a sub-set of the list provided in the Audit Plan. The nature, extent, and timing of audit activities will vary as a result of the differences in the nature of operations, organizational structure, and management style as well as by the competence, employee capabilities, and concepts of operational control.

The Audit Division will also provide any assistance to City's management or City Council when they request special projects (*assuming the available resources exist, and depending on the context and priority of the assignment as it relates to risk, exposure, fraud, waste and/or abuse*). These special projects will normally be performed in addition to planned audit work. If the assistance requires the use of external consultants, additional funds may need to be provided by the appropriate departments and/or City Council.

Executing the Audit Plan involves an update and status process that is scheduled weekly between the City Auditor and the City Controller. Additionally, the Audit Division posts a high-level status report on the Audit Division's website, accessible from the City Controller's Webpage. Post-Audit Surveys are completed and Requests for Audit Services are also available from the Audit Division's website.[3]

ANTICIPATED BENEFITS OF AUDIT ACTIVITIES –

Compliance

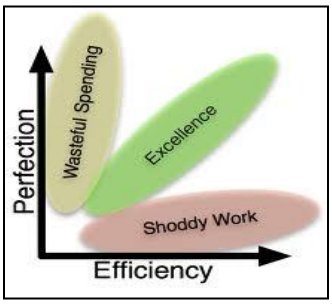
Improve Accountability

Cost Savings

Improve Risk Management and Internal Controls

Improve Financial Reporting

Improve Efficiency



[3] The Audit Division has a website accessible from the Controller's website, which post results of audits, follow-up procedures, and status of progress. SEE: http://www.houstontx.gov/controller/audit

FISCAL YEAR 2014 PLANNED ACTIVITY (PROJECTS)

The following is a list of projects for the FY 2014 Annual Audit Plan. The Audit Process, while often tracked in a linear fashion, is truly dynamic and reacts to evidence, impact, and magnitude of discovery occurring during the entire engagement process. That being the case, the list provided, gives a population of projects from which to execute. The Office of the City Controller's Audit Division posts status/progress of projects on the Audit Division website and meets with the City Controller weekly and the Budget and Fiscal Affairs Committee of City Council twice a year. This provides a level of transparency and accountability for meeting our goals and objectives as set herein.

COMPLIANCE/PERFORMANCE/FINANCIAL AUDITS AND PROCESS REVIEWS

FLEET MANAGEMENT DEPARTMENT (FMD) –

PERFORMANCE /CONTRACT COMPLIANCE – VEHICLE REPLACEMENT PART SUPPLY CONTRACT WITH NAPA

DESCRIPTION: Several City Departments acquire, maintain, and dispose fleet vehicles that vary from standard automobiles (fuel, hybrid, and electric), trucks (pick-up, straight, dump, etc.), heavy equipment, and specialized vehicles for specific purpose (Fire, Emergency Medical Transportation, Waste, etc.). During FY2011 Fleet Management functions from various departments were consolidated into a newly formed Fleet Management Department. The process for managing spare/replacement parts inventory was outsourced to the Genuine Parts Company (NAPA) as supported by City contract #4600010761. The total contract value was $95 million over a 5 year term. Since the inception of the contract, the City has paid the vendor approximately $35 Million. The audit will focus on compliance with key contract terms and management controls in place to monitor the contract activity, spending, and efficiency.

CITY-WIDE POLICY FRAMEWORK –

PERFORMANCE/COMPLIANCE AUDIT AND EFFICIENCY OF DESIGN REVIEW – CITY-WIDE ADMINISTRATIVE PROCEDURES, EXECUTIVE ORDERS, AND MAYOR'S POLICIES (CO-SOURCE WITH AN EXTERNAL CONSULTANT)

DESCRIPTION: Policy and procedures are created by management to outline a framework to direct behavior in alignment with mission and objectives significant to the operations as it defines the internal controls to mitigate risks associated with processes, resources, laws and regulations. The Audit Team has developed a strategy to gain coverage of auditing for compliance and the overall design as it pertains to management objectives.

PUBLIC WORKS AND ENGINEERING (PWE) –

PERFORMANCE/COMPLIANCE OR PROCESS REVIEW – ACCOUNTING FOR PROP 1/SPECIAL REVENUE FUNDS (CO-SOURCE WITH AN EXTERNAL CONSULTANT)

DESCRIPTION: Proposition 1 was passed in November 2010, which created the need for changes to process and accounting of various activities related to infrastructure develop/re-development. The audit team will review, document and walkthrough a series of activities to identify key business processes, project set-up, tracking, and management of out-sourced functions.

FINANCE DEPARTMENT (FIN)-STRATEGIC PURCHASING DIVISION;

PERFORMANCE/CONTRACT COMPLIANCE AUDIT – BUILDING AND MAINTENANCE SERVICES CONTRACT – MCLEMORE (CO-SOURCE WITH AN EXTERNAL CONSULTANT)

DESCRIPTION: The City utilizes an external vendor to perform some of the building maintenance services for various departments. During FY2013 two contracts were renewed with a long-term vendor for four departments which totals approximately $3 Million. The audit team will review and validate compliance with key terms and conditions of these agreements.

HOUSTON AIRPORT SYSTEM (HAS)–

CONTRACT COMPLIANCE AUDIT - CONSTRUCTION ACTIVITY (CO-SOURCE WITH AN EXTERNAL CONSULTANT)

DESCRIPTION: HAS engages in significant contract activity for airport, terminal, facilities, security, maintenance, improvements, and repairs. One construction contract type that has potential for cost recovery and effective partnership is referred to as a Construction Manager at Risk (CMAR). During the FY2011, the Office of the City Controller performed an audit of Phase 1 of Project 417F which utilized Clark Construction Company as the CMAR. The project has been completed in two additional phases. The Audit Team will perform a closeout audit of the remaining activity that applies to Phase II and III, which approximates $100 million in project costs.

CARRYOVER AUDITS FROM FY2013 AUDIT PLAN

The following projects began during FY2013 and are being completed in FY2014:

ADMINISTRATION AND REGULATORY AFFAIRS DEPARTMENT (ARA); INFORMATION TECHNOLOGY DEPARTMENT (ITD)

COMPLIANCE AND PERFORMANCE AUDIT – P-CARDS

DESCRIPTION: P-Cards are used throughout the City and involve vendors/merchants, the bank that issues and processes the detail information, interface with the ERP/SAP. Because of the volume, complexity and number of entities/systems involved, the Audit will focus on reviewing current controls over the issuance, use and approval of P-Cards and the verification of the accuracy of information posted/interfaced to the ERP/SAP system.

HUMAN RESOURCES (HR) –

PERFORMANCE AUDIT/CONTRACT COMPLIANCE – EMPLOYEE BENEFITS

DESCRIPTION: During FY2011, the City changed its employee benefits program and engaged in a contract with a new vendor to be the administrator over medical benefit activities. This marks a change from a coverage program represented by premium payments to the shift of risk to the City by paying actual medical costs for employee health care. The audit will focus on the bidding process, employee premiums, and employer payments, etc.

PUBLIC WORKS AND ENGINEERING (PWE) –

PERFORMANCE AUDIT – ENGINEERING AND CONSTRUCTION

DESCRIPTION: The Audit Division will review the customer utility service system, while considering the following potential objectives: (a) Accuracy of meters that support customer billing, (b) Business Processes that validate customer billing, including the protocol for working through 'service' concerns expressed by our customers (checking meters, reasonableness of billing amount, etc.) (c) Current constraints that may be in place in our ordinance(s) that could be re-framed to minimize legal pressures imposed on customers

INFORMATION TECHNOLOGY DEPARTMENT (ITD) – (OUTSOURCED)

CONTRACT COMPLIANCE – LOCAL TELECOM EXPENSE (LANDLINES ONLY)

DESCRIPTION: The City spends approximately $10 - 12 Million per year on local landline telephone services. The rates for services are per contract and subject to tariffs. The audit tested existence of lines being charged and the accuracy of the charges per the agreement or the appropriate tariff/rate.

HOUSTON AIRPORT SYSTEM (HAS)–

PERFORMANCE/CONTRACT COMPLIANCE AUDIT – RENTAL CAR AGENCIES (CO-SOURCED)

DESCRIPTION: HAS has several contracts for concessions, parking management, and off-site parking. The concession contracts and the off-site parking are based primarily on self-reporting by the vendor. One type of concession/revenue based contract is with Rental Car Companies with locations at both Intercontinental and Hobby airports. The audit team is co-sourcing a compliance audit of the self-reporting vendors for the Rental Car Companies and the internal controls associated with oversight to ensure revenues due to HAS/COH are identified, reported and collected.

HUMAN RESOURCES (HR) –

PERFORMANCE REVIEW/ANALYSIS – DRUG BENEFIT PROGRAM MANAGEMENT

DESCRIPTION: During FY2011, the City changed its employee benefits program and engaged in a contract with a new vendor to be the administrator over medical benefit activities, including managing the pharmacy benefit program. This marks a change from a coverage program represented by premium payments to the shift of risk to the City by paying actual medical costs for employee health care. The review will focus on a cost analysis of contract terms for drug pricing, formulary brand determination, rebates, etc.

ALTERNATIVE AUDIT PROJECTS FY2013

The Audit Plan is flexible based on changes to scope, staffing, access to information and other factors. If time and resources permit, the following projects may be substituted for or performed in addition to the previously identified projects.

HOUSTON AIRPORT SYSTEM (HAS)–

COMPLIANCE AUDIT – TERMINAL PARKING

DESCRIPTION: HAS has several contracts for concessions, parking management, and off-site parking. The parking management is a paid contractor to handle cash for the parking facilities located at the various airport terminals. The estimated revenue for terminal parking is $65 - $70 million per year. The audit team will focus on vendors for terminal parking and the internal controls associated with oversight to ensure revenues due to HAS/COH are identified, reported and collected.

HOUSTON POLICE DEPARTMENT (HPD)–

PERFORMANCE/COMPLIANCE AUDIT – SUPPORT OPERATIONS, PROPERTY/EVIDENCE ROOM

DESCRIPTION: In the recent past, HPD has implemented a new Evidence Management System (EMS) and moved their property room to a new location. In addition, they have implemented Daily and Close-out audits. This audit will focus on ensuring the accuracy of the EMS and compliance with their policy and procedures.

GENERAL SERVICES DEPARTMENT (GSD) –

PERFORMANCE/CONTRACT COMPLIANCE AUDIT – FACILITIES/BUILDING MAINTENANCE – CONSTRUCTION AND RENOVATION WORK ORDERS

DESCRIPTION: GSD engages in contracts in construction activity for projects and maintenance of City assets. During FY2011, GSD spent approximately $8.5 Million on these services to outside contractors. The audit will focus on compliance with contract billing terms and change order processes.

HOUSTON DEPARTMENT OF HEALTH AND HUMAN SERVICES (HDHHS)

PERFORMANCE/COMPLIANCE – PHARMACY INVENTORY

DESCRIPTION: Approximately $9.1 Million was spent on Lab, Drugs, and Medical Chemical Supplies during the FY2011 while the Inventory Balance was approximately $16.7 Million for the same period. Audit Division will review Pharmacy inventory processes, controls and record-keeping to determine if inventory is ordered, received, issued, stored, and maintained in compliance with various requirements (current Federal, State, City, and manufacturer).

SPECIAL PROJECTS & ONGOING MONITORING PROCEDURES

CITIZEN CENTRIC REPORTING (CCR)

DESCRIPTION: The Association of Government Accountants (AGA) posts condensed reports of jurisdictions aimed at being "user" or constituent-friendly. The Comprehensive Annual Financial Report (CAFR) contains a wealth of financial, demographic, performance, and disclosure information and typically exceeds 300 pages. The goal of the CCR is to select key information (quantitative and qualitative) about the governmental entity and present it in a four-six page synopsis. The report generally includes visual presentation aids, such as charts, graphs, tables, etc. The professional staff assigned to this project will create a CCR for the City of Houston and post publicly on the Controller's website and the AGA website.

AUDIT WORKPAPER SOFTWARE IMPLEMENTATION

DESCRIPTION: The Audit Division has been using automated workpapers since 2000. The existing product was no longer supported by the developer and was not sufficient to meet the growing needs and capabilities of the Audit Function. The Office of the City Controller purchased new software and the audit team is in the process of implementing the system, while archiving and transferring information from the old system.

A-133 SINGLE AUDIT ASSISTANCE

DESCRIPTION: The external audit of the Comprehensive Annual Financial Report (CAFR) has typically involved at least 2,000 hours of billable time to perform testing and preparing the report associated with grants that are subject to the A-133 compliance requirement. During FY2013, the Audit Division tested 19 of the 20 required programs subject to A-133, which resulted in a savings exceeding $250,000 to the City. During FY20134, the Audit Division will continue providing assistance by using internal resources exclusively.

While continuing to save the City audit fees by assisting in testwork, the mid and long-term goals have been to increase knowledge of the significant grant activities in which the City is involved and help the City achieve an assessment of a "low risk" entity, which reduces the required A-133 testing by 50%. Additionally, this becomes a mechanism that assists City Management in designing and developing a stronger internal control structure.

ENTERPRISE RISK ASSESSMENT (ERA)

DESCRIPTION: Each year the Audit Division develops the Audit Plan based upon risk (primarily business, financial, operational, etc.) Key benefits include; gains in significant knowledge, goodwill, and succession planning by having a diverse team exposed to all the major operations of the City. Professional auditing standards (both GAO and IIA) require audit resources to be allocated to projects based on continued risk assessment methodology. There are currently 4 major components to the ERA Process (1) Review of selected departments on a rotational basis, (2) Significant Events occurring during the FY, (3) Changes to major process, structure, leadership within the City, (4) Consideration of Information Systems.

FOLLOW-UP PROCEDURES

DESCRIPTION: As issues are identified during the course of conducting audits/engagements, they are documented and reported accordingly. In order to help initiate change and continued improvement, we communicate with responsible management at regular intervals, and obtain a status of progress on implementation of corrective actions. These communications are formally documented. Additionally, samples of items are tested on a periodic basis, depending on the magnitude, impact, and cost-savings with the results being published as formal reports that disclose status of open items and assess the overall remediation process employed by management.

QUALITY ASSURANCE PROCEDURES

DESCRIPTION: Professional standards require that the audit function have a system of quality control/assurance in place to ensure all necessary elements are in place and operating effectively. Each audit/project is reviewed by a professional staff not directly assigned to the audit. The goal is to verify that sufficient, appropriate evidence is gathered and documented do adequately support conclusions based on procedures that are designed to test relevant audit objectives (this includes consideration of Fraud, professional judgment, competency, and supervision).

FRAUD HOTLINE/REPORTING

DESCRIPTION: The Office of the City Controller provides two primary vehicles for reporting fraud, waste and/or abuse: (1) A Fraud Hotline answered by the Audit Division and (2) a link to report fraud available from both the Controller's Homepage and the Audit Division's Website. Additionally, the Audit Division provides auditing support based on requests from the OIG and/or other authorities. Each reported concern is addressed. This may result in performing substantive procedures, such as an audit, or may be referred to an outside agency or department for follow-up. The initial contact, work performed, conclusions and/or referral are documented to support their disposition. In some instances, this may also require subsequent follow-up or monitoring to adequately resolve. Consideration of Fraud Reporting is performed by the Audit Division on a regular basis and has direct involvement by professional staff that are Certified Fraud Examiners.

DATA ANALYTICS AND CONTINUOUS AUDITING

DESCRIPTION: The Audit Division purchased computer software during FY 2009 that allows for data access, extraction, warehousing, and analysis. This system also provides the functionality of a computer assisted auditing tool (CAAT). The implementation began during the last quarter of FY 2009 and is continuing into FY 2013 based upon resource availability[4].

The first phase of Continuous Auditing is integrating the tools capabilities within the Enterprise Resource Planning (ERP) environment. This has consisted of understanding the business process and how the information system captures and stores the relevant information. We have selected some procurement process transaction types that we are using as a basis to implement and advance this initiative. Other areas of are:

- Accounts Payable;
- Purchasing/Procurement Cards (P-Cards);
- Accounts Receivable; and
- Payroll.

Subsequent phases will detail more specific analytics tailored to City concerns of fraud, waste, and/or abuse, as well as perform analysis of other non-integrated systems. This will then allow our focus to be on identified performance measures and other potential anomalies for consideration of risk, contribution to the ERA, and support for future audit planning.

UNANNOUNCED AUDITS

DESCRIPTION: The Audit Division may perform audits on an unannounced basis during the year. These may include:

- Compliance with Specific Administrative Procedures or Executive Orders
- Petty Cash Counts;
- Inventory Audits (Test Counts/Controls

David A. Schroeder, CPA, CISA
City Auditor

[4] In order to continue successful implementation, the Audit Division needs to fill a current vacancy with the specialized skills to utilize CAATs.