



External Quality Control Review

of the
City of Houston
Office of the City Controller
Audit Division

Conducted in accordance with guidelines of the
**Association of Local Government
Auditors**
for the period July 1, 2009 through June 30, 2010



Association of Local Government Auditors

July 30, 2010

Mr. David A. Schroeder
City Auditor
Office of the City Controller
Audit Division
City of Houston
901 Bagby, 9th Floor
Houston, TX 77251

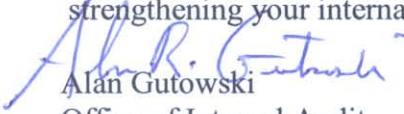
Dear Mr. Schroeder,

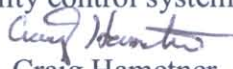
We have completed a peer review of the City of Houston Office of the Controller Audit Division for the period July 1, 2009 through June 30, 2010. In conducting our review, we followed the standards and guidelines contained in the *Peer Review Guide for Assessing Conformance with International Standards for the Professional Practice of Internal Auditing*, published in July 2009 by the Association of Local Government Auditors (ALGA).


We reviewed the internal quality control system of your audit organization and conducted tests in order to determine if your internal quality control system operated to provide reasonable assurance of conformance with *the International Standards for the Professional Practice of Internal Auditing (the Standards)* issued by The Institute of Internal Auditors. Due to variances in individual performance and judgment, conformance does not imply adherence to standards in every case, but does imply adherence in most situations.

Based on the results of our review, it is our opinion that the City of Houston Office of the Controller Audit Division internal quality control system was suitably designed and operating effectively to provide reasonable assurance of conformance with *the Standards* for assurance and consulting engagements during the July 1, 2009 through June 30, 2010.

We have prepared a separate letter providing details of our findings and recommendations for strengthening your internal quality control system.


Alan Gutowski
Office of Internal Audit
& Investigations
City of Albuquerque, NM


Craig Hametner
Internal Audit Department
City of Garland, TX


Edmundo Calderon
Internal Audit Office
City of El Paso, TX



Association of Local Government Auditors

July 30, 2010

Mr. David A. Schroeder
City Auditor
Office of the City Controller
Audit Division
City of Houston
901 Bagby, 9th Floor
Houston, TX 77251

Dear Mr. Schroeder,

We have completed a peer review of the City of Houston Office of the Controller Audit Division for the period July 1, 2009 through June 30, 2010 and issued our report dated July 30, 2010. We are issuing this companion letter to offer certain observations and suggestions stemming from our peer review.

We would like to mention some of the areas in which we believe your office excels:

- The City Auditor and his staff have demonstrated a strong commitment to following the *International Standards for the Professional Practice of Internal Auditing (the Standards)* by:
 - Implementing an automated work paper system to improve documentation of audit evidence;
 - Developing policies and procedures that address standards; and
 - Obtaining an external peer review.

The staff is very qualified to perform their duties.

We offer the following observations and suggestions to enhance your organization's demonstrated conformance with *the Standards*:

- **Observation 1:** The current internal audit charter is not up to date. It is signed by the previous City Controller and City Auditor as September 3, 2009. *Standard 1000 – Purpose, Authority, and Responsibility – The purpose, authority, and responsibility of the internal audit activity must be formally defined in an internal audit charter, consistent with the Definition of Internal Auditing, the Code of Ethics, and the Standards. The chief audit executive must periodically review the internal audit charter and present it to senior management and the board for approval.*

Suggestion 1: The City Auditor should update the existing internal audit charter to reflect the current City Controller and City Auditor.

- **Observation 2:** There is no established Audit Committee. The City Auditor reports to the City Controller only. There is not a dual reporting relationship for the City Auditor. *Standard 1100 – Independence and Objectivity – The internal audit activity must be independent, and internal auditors must be objective in performing their work.*

The City Auditor is in the process of establishing an Audit Advisory Group. This group has the potential of becoming the audit committee necessary to meet the requirements of the Standard.

Suggestion 2: Continue with the process of establishing the Audit Advisory Group with the potential of it becoming the Audit Committee.

- **Observation 3:** The original Audit Plan developed by the previous City Auditor does not contain a formal Risk Assessment. A revised Audit Plan has been developed by the current City Auditor which does contain a Risk Assessment, but it is in draft form and has not been approved by Senior Management.
Standard 2010 – Planning – The chief audit executive must establish risk-based plans to determine the priorities of the internal audit activity, consistent with the organization's goals.
Standard 2120 – Risk Management – The internal audit activity must evaluate the effectiveness and contribute to the improvement of risk management processes.
Standard 2120.A1 – The internal audit activity must evaluate risk exposures relating to the organization's governance, operations, and information systems regarding the:
 - *Reliability and integrity of financial and operational information;*
 - *Effectiveness and efficiency of operations;*
 - *Safeguarding of assets; and*
 - *Compliance with laws, regulations, and contracts.*

Standard 2120.A2 – The internal audit activity must evaluate the potential for the occurrence of fraud and how the organization manages fraud risk.

Suggestion 3: Complete the process of having the revised Audit Plan approved by Senior Management.

- **Observation 4:** No follow-up audits were completed during the review period. The City Auditor has established a policy and procedures on conducting follow-up audits in the future. *Standard 2500 Monitoring Progress – The chief audit executive must establish and maintain a system to monitor the disposition of results communicated to management.*

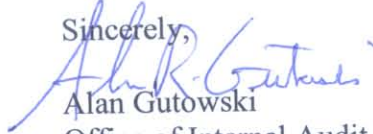
Suggestion 4: The City Auditor should continue with his plan of completing follow-up audits on future audit plans.





Association of Local Government Auditors

We extend our thanks to you, your staff and the other city officials we met for the hospitality and cooperation extended to us during our review.

Sincerely,


Alan Gutowski
Office of Internal Audit
& Investigations
City of Albuquerque, NM


Craig Hametner
Internal Audit Department
City of Garland, TX


Edmundo Calderon
Internal Audit Office
City of El Paso, TX



July 30, 2010

Alan Gutowski
Office of Internal Audit and Investigations
City of Albuquerque
1 Civic Plaza Northwest
Albuquerque, NM 87102

Mr. Gutowski,

We have received the results from the Association of Local Government Auditors' (ALGA) peer review you performed of the Audit Division within the Office of the City Controller for the period of July 1, 2009 through June 30, 2010. We acknowledge your opinion that *our internal quality control system was suitably designed and operating effectively to provide reasonable assurance of conformance to the International Standards for the Professional Practice of Internal Auditing (The Standards/Redbook) issued by the Institute of Internal Auditors (IIA).*

We recognize this as **full conformance** and also appreciate the recommendations that your review provided as an opportunity for us to improve. Please see our responses to your observations and recommendations on the following pages.

We found the overall process valuable to our function. You performed the engagement in a professional manner and displayed an increasing development of the necessary foundation to understand the environment that we operate and how the auditing standards can be applied in meeting our mission and objectives.

We would like to express our appreciation to you and the rest of the ALGA peer review team:

Edmundo Calderon
Chief Internal Auditor
El Paso, Texas

Craig Hametner
City Auditor
Garland, Texas

Sincerely,

A handwritten signature in blue ink that reads "David A. Schroeder".

David A. Schroeder
City Auditor
City of Houston

IIA STANDARDS/REDBOOK

- **“Observation 1:** The current internal audit charter is not up to date. It is signed by the previous City Controller and City Auditor as September 3, 2009. *Standard 1000 – Purpose, Authority, and Responsibility – The purpose, authority, and responsibility of the internal audit activity must be formally defined in an internal audit charter, consistent with the Definition of Internal Auditing, the Code of Ethics, and the Standards. The chief audit executive must periodically review the internal audit charter and present it to senior management and the board for approval.”*

RESPONSE: We have updated and revised our Audit Division Charter which is signed by the current City Controller and City Auditor.

We respectfully disagree with the peer review team's interpretation. *The Standards* define the Audit Charter as a document that outlines the internal audit activity specific to the entity (purpose, authority, responsibility, accountability, etc.). This does not associate the document with a person, but rather the activity and its representative positions. Thus, it requires updating when the structure of the function changes, not necessarily when specific changes in administration occur (similar to a City Charter). We do, however, appreciate your position that turnover in the people that hold offices of responsibility and accountability should sign the Audit Division Charter as a symbol of their commitment to the principles reflected in the document.

- **“Observation 2:** There is no established Audit Committee. The City Auditor reports to the City Controller only. There is no dual reporting relationship for the City Auditor. *Standard 1100 – Independence and Objectivity – The internal audit activity must be independent, and internal auditors must be objective in performing their work.”*

The City Auditor is in the process of establishing an Audit Advisory Group. This group has the potential of becoming the audit committee necessary to meet the requirements of the Standard.”

Response: We have taken a proactive approach in forming an Audit Advisory Group and believe that initiating regular interactions with stakeholders is important in providing value, transparency, and an additional forum for communications beyond the required channels of audit report distribution.

We respectfully disagree with the peer review team's interpretation that 'dual reporting' is a requirement of the standard. Additionally, *Standard 1100* and the related Practice Advisory do not mandate an audit committee. In looking at *The Standards*, it may be helpful to consider that they were derived from the private sector internal audit model which typically resides within the finance function and/or reports to a CFO, which would require an additional arm for independence. This is commonly achieved through an Audit Committee or sub-committee of the Board of Directors. In the public sector, different organizational structures exist. The City of Houston has a strong Mayoral form of government, and an independently elected City Controller, charged with the 'Internal Audit Function'. Therefore, by Charter and the constituent voting process, the internal audit activity of the Audit Division resides outside of operations. Lastly, the City Charter assigns audit authority and responsibility to the City Controller (Article VIII, Section 7) which is defined as an independent function legislatively.

CITY AUDITOR'S RESPONSES

- **“Observation 3:** The original Audit Plan developed by the previous City Auditor does not contain a formal Risk Assessment. A revised Audit Plan has been developed by the current City Auditor which does contain a Risk Assessment, but it is in draft form and has not been approved by either Senior Management.”

Response: *We concur.* The Current Audit Plan will be issued August 2010, which; is derived from risk-based methodology, approved by the City Controller, and issued as a public document.

- **“Observation 4:** No follow-up audits were completed during the review period. The City Auditor has established a policy and procedures on conducting follow-up audits in the future. *Standard 2500 Monitoring Progress – The chief audit executive must establish and maintain a system to monitor the disposition of results communicated to management.*”

Response: *We concur.* The last follow-up audit was completed in April of 2009. We have changed our follow-up process as reflected in our Policies and Procedures, and the Annual Audit Plan for Fiscal Year 2011. Our new approach provides ongoing monitoring of findings, recommendations, and the related management responses for implementation of improvements and/or corrective actions. This involves quarterly review of management status reporting and semi-annual testing of a sample population of significant items, by utilizing reporting capability within our automated workpaper environment.

CITY AUDITOR'S ACKNOWLEDGEMENT

I acknowledge the responses presented above as the commitments and representations of the City Auditor of Houston, TX relating to the observations and recommendations provided by the ALGA peer review team in assessing our conformance with the IIA Standards for the period of July 1, 2009 through June 30, 2010.



David A. Schroeder
City Auditor
City of Houston