

OFFICE OF THE CITY CONTROLLER



FISCAL YEAR 2012

AUDIT PLAN

Ronald C. Green, City Controller

David A. Schroeder, City Auditor



OFFICE OF THE CITY CONTROLLER
CITY OF HOUSTON
TEXAS

RONALD C. GREEN

September 9, 2011

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

SUBJECT: Office of the City Controller
Fiscal Year 2012 Audit Plan

Dear Mayor Parker and Council Members:

I am pleased to submit to you the Fiscal Year 2012 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 Office, City Council Members, 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 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.

Our Audit Advisory Group (AAG), scheduled to meet twice a year for status and progress of executing the Audit Plan and to discuss other pertinent audit issues. The AAG involves voluntary participation as coordinated by my office.

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 FY2011, the Audit Division reduced staff by 2 FTE's bringing the total headcount to 12, consisting of 10 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, 2016.

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 Controller has initiated an Audit Advisory Group which is scheduled to meet twice a year.

The professional standards noted previously require that the Audit Plan be rooted in risk-based methodology. Historically, the Audit Division has 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). Going forward, 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 period¹.

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



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 management resource through 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 engagement²;
- 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.

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 performed monthly 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



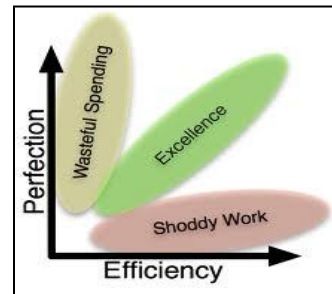
Improve Risk Management and Internal Controls



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 2012 PLANNED ACTIVITY (PROJECTS)

The following is a list of projects for the FY 2012 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 has initiated an Audit Advisory Group, which will be a vehicle for interaction between the governing body, operations, and the monitoring group. This will also provide a level of transparency and accountability for meeting our goals and objectives as set herein.

COMPLIANCE AND/OR CONTRACT AUDITS

GENERAL SERVICES DEPARTMENT (GSD) –

1. CONTRACT COMPLIANCE AUDIT – CONSTRUCTION AND RENOVATION

DESCRIPTION: GSD engages in contracts for construction activity for projects and maintenance of City assets. The audit will focus on compliance with contract billing terms and change order processes.

HOUSTON AIRPORT SYSTEM (HAS)–

2. CONTRACT COMPLIANCE AUDIT – CONCESSION CONTRACTS

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, while 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 perform a contract compliance audit of the self-reporting vendors for concessions and the internal controls associated with the cash handling procedures performed by the vendor managing the airport terminal parking lots.

HUMAN RESOURCES (HR) –

3. PERFORMANCE AUDIT/CONTRACT COMPLIANCE – EMPLOYEE BENEFITS

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.

ADMINISTRATION AND REGULATORY AFFAIRS DEPARTMENT (ARA)–

4. CONTRACT COMPLIANCE AUDIT – STRATEGIC PURCHASING DIVISION (SPD) CONTRACT MANAGEMENT

DESCRIPTION: ARA/SPD negotiates and engages in large contracts for goods and services on behalf of the City. Some of these contracts have guarantees over pricing to ensure the City is paying the lowest possible price. The audit will examine and test a contract for goods and/or services to verify compliance with contract terms.



INFORMATION TECHNOLOGY DEPARTMENT (ITD) – (OUTSOURCED)

5. 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 will test the existence of lines being charged and the accuracy of the charges per the agreement or the appropriate tariff/rate.

PERFORMANCE/FINANCIAL AUDITS AND PROCESS REVIEWS

HOUSTON PUBLIC LIBRARY (HPL) –

6. FINANCIAL AUDIT – HOUSTON PUBLIC LIBRARY FOUNDATION (HPLF)

DESCRIPTION: HPLF is a component unit of the City that serves the needs of the HPL through the receipt of donations and the income from invested corpus. The Net Assets for the FY2010 were approximately \$20 million. The HPLF seeks to discontinue being a component unit and operate independent of the City. The audit team will review financial information in attempting to determine controls over reporting of donations (donor intent, etc.)

PUBLIC WORKS AND ENGINEERING DEPARTMENT (PWE) –

7. PROCESS REVIEW – CONSTRUCTION PROJECTS

DESCRIPTION: During FY2011, PWE had expended approximately \$534 million to Construction In Progress (CIP). The Department engages in a significant number of construction contracts. The audit team will review, document and walkthrough a series of projects to identify key business processes, project set-up, tracking, procurement, inspections, approvals, payment, and final acceptance of work by City Council.

HOUSTON FIRE DEPARTMENT (HFD); FINANCE DEPARTMENT (FIN); ADMINISTRATION AND REGULATORY AFFAIRS DEPARTMENT (ARA) – (CO- SOURCED AUDIT)

8. BUSINESS PROCESS AND AGREED UPON PROCEDURES – EMERGENCY MEDICAL SERVICES (EMS)

DESCRIPTION: HFD provides EMS, including transportation services for people in need of emergent care. There are several factors to consider in the entire process, which include:

- Provision of services as per ordinance and mission;
- Documentation required for proper record-keeping to support services provided; and
- Billing and collection of services provided, which include monitoring of aging, etc.

During FY2011, the City provided approximately 130,000 transportation services, that translated into approximately \$60 Million in gross billings, which netted roughly \$24 Million to the City. The engagement will focus on identifying the composition of the services provided as well as the associated costs for each.



CARRYOVER AUDITS FROM FY2011 AUDIT PLAN

The following projects began during FY2011 and are being completed in FY2012:

PARKS AND RECREATION DEPARTMENT (PARC) –

9. CONTRACT COMPLIANCE/PERFORMANCE AUDIT OF GOLF COURSES⁴

DESCRIPTION: PARC has four City-run golf courses and three that are run by contracted parties (privatized). This is an enterprise activity with significant cash handling responsibilities and non-integrated accounting systems. The audit is focused on selecting a combination of both City-run and privatized golf courses to engage in a performance audit of internal controls over revenue recognition/recording, cash handling, expenses, inventory, and fixed assets.

The report from the audit of City-Run Golf-Courses was issued June 15, 2011 as Report #2011-05. The two PARC Privatized Golf Course Contract Audits will be completed and the results will be released during FY2012.

FLEET MANAGEMENT DEPARTMENT (FMD) –

10. LIMITED CONTRACT REVIEW – REPAIR PARTS INVENTORY MANAGEMENT

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 was consolidated into a newly formed Fleet Management Department. The process for managing spare/replacement parts inventory was outsourced. Also, most of the existing inventory for repair parts was sold to a vendor, which had an original book value of approximately \$3.5 million. The audit team observed the inventory process and is examining the supporting documentation related to the sale of the existing parts inventory.

NOTE: The most significant Departments having fleet activities are; HFD, Houston Police Department (HPD), PWE, PARC, and Solid Waste Management Department (SWM).

⁴ The Audit Team will be considering **compliance factors** in performing an Audit on the Privatized Golf Course, while also executing a Performance Audit of the City-Run locations.



SPECIAL PROJECTS & ONGOING MONITORING PROCEDURES

11. 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. Due to the American Recovery and Reinvestment Act (ARRA), the required amount of testing has substantially increased. During FY2011, the Audit Division tested 18 out of the 21 required programs subject to A-133, which resulted in a savings of at least \$250,000 to the City. During FY2012, the Audit Division will continue providing assistance by using a combination of internal resources and outsourced assistance.

While continuing to save the City audit fees by assisting in testwork, the mid and long-term goals are 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. This could likely result in a further reduction to the required substantive testing because the external auditor would then be able to rely on internal controls in performing the rest of the financial statement audit. Benefits also come from identifying inefficiencies in business processes and helping identify, develop, and share best practices.

12. ENTERPRISE RISK ASSESSMENT (ERA)

DESCRIPTION: Each year the Audit Division develops the Audit Plan based upon risk (primarily business, financial, operational, etc. Key benefits are 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. Going forward, annual risk assessments will be performed on approximately 5-6 Departments per year, allowing full coverage of the City on a recurring 4-5 year rotation.

13. 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 are modifying our follow-up procedures to effectively monitor progress on implementation of management responses to our recommendations. Rather than perform follow-up audits, we will be communicating with responsible management at regular intervals, inquiring as to the progress on implementation of corrective actions. These communications will be formally documented and published accordingly. Additionally, a sample of items will be tested on a periodic basis, depending on the magnitude, impact, and cost-savings with the results published as well.

14. 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 to adequately support conclusions based on procedures that are designed to test relevant audit objectives (this includes consideration of Fraud, professional judgment, competency, and supervision).



15. 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 has to be 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. Considerations 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 will continue into FY 2012 based upon resource availability⁵.

The first phase of Continuous Auditing is integrating the tools capabilities within the Enterprise Resource Planning (ERP) environment. This will consist of pre-defined analytics in conjunction with the development and implementation of custom written templates to address specific auditing needs. The initial emphasis will be looking at transactions involving some of the following:

- 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:

- Petty Cash Counts;
- Payroll Verification (Employee Existence Verification); and
- Inventory Audits (Test Counts/Controls).

⁵ In order to continue successful implementation, the Audit Division needs to fill a current vacancy with the specialized skills to utilize CAATs.