



**CITY MANAGER'S OFFICE  
M E M O R A N D U M**

August 20, 2008

**TO:** Ruffin Hall, Budget and Evaluation

**FROM:** Greg McDowell, City Auditor  
Wilson Hooper, Assistant to the City Manager

**SUBJECT:** Internal Audit FY2009 SOP Transmittal Memo

---

The Office of Internal Auditor (IA), a division of the City Manager's Office, exists to conduct independent and objective appraisals of the City's system of internal controls, the efficiency of operations, and the effectiveness with which these functions are managed. This memo transmits IA's FY2009 strategic operating plan.

For FY09 IA's work will include continuation, where necessary, of efforts begun in FY08 as well as initiation of a new slate of audits that are in keeping with corporate strategy and undertaken to respond to critical organizational needs. In FY08 IA completed a challenging schedule of managed-competition and other performance audits. Significant efforts were made to review the City's procurement policies and procedures, and to support CATS light rail construction. FY09 will include KBU-specific procurement policy reviews, and expanded audits of CATS construction and operations. Additionally, in FY09 IA will conduct managed-competition reviews of Solid Waste Services, CMU Water and Wastewater treatment plants, and CDOT Street Maintenance. IA also plans to work to increase its own efficiency by implementing an Electronic Workpaper Software system, and preparing its staff to respond effectively to emergency requests for investigation. Details of these efforts and others in IA's work plan are included in the attached SOP document.

In order to accomplish its work plan, IA must maintain a staffing level equivalent to 10 FTEs. The FY09 budget allocates 9.00 FTEs, but includes an increased allocation to our #199 line item in order to pay for contractual services that will make up the difference.

In addition to workload and staffing, IA acknowledges other challenges on the horizon in FY09. Achieving and maintaining professional certifications, a specific BSC goal, requires participation in both Continued Professional Education courses and professional associations. Balancing travel and training demands with obligations to the City, and paying for such activities with limited resources, will require creativity and special attention on the part of IA

staff.

Internal Audit embarks into FY09 with an SOP designed to contribute to the overall success of the City of Charlotte. We're proud to be an important part of this organization.

Attachments:

- 1.) Memorandum "Internal Audit –FY09 Strategic Operating Plan"
- 2.) IA Balanced Scorecard

CC. Curt Walton, City Manager  
Leadership Team  
Phyllis Heath

# CITY OF CHARLOTTE

## CITY MANAGER'S OFFICE – INTERNAL AUDIT DIVISION

### MEMORANDUM

To: Budget & Evaluation  
From: Greg McDowell, City Auditor  
Re: Internal Audit –FY09 Strategic Operating Plan

July 30, 2008

With this submittal, we are providing the Audit Division's first Balanced Scorecard.

### **Priorities for 2009**

1. **Managed Competition** – The City's established program relies upon Internal Audit's timely support and completion of regular audits. We must continue and improve this support, in the following three areas:
  - **Solid Waste Services:** All three Solid Waste contracts were audited through December 31, 2007, including the East District which had been cancelled by the City Manager, in order to provide a basis to support the East's bid numbers. It is unclear whether a June 30, 2008 audit will be required for the East, but both North and South Districts are being audited for the six month period ended June 30<sup>th</sup>. (Both SWS staff and Internal Audit staff focused on the East bid rather than conducting a March 31<sup>st</sup> audit.) Internal Audit received SWS's proposed FY09 optimized budgets in mid-July and is reviewing them.
  - **CMU Water and Wastewater Plants:** CMU audits have fallen behind due to a few circumstances. The new Utilities Optimization (WWOP) encompasses four plants (Mallard, McDowell, Sugar, and McAlpine) as well as the Maintenance area for these four. The initial budgets for these five entities were not approved by Internal Audit until September 2007, due to late submittals from CMU. The grouping of five separate cost centers' expenses has proven to be a challenge for all involved. We are working on an initial six-month audit (through December 31, 2007) and will perform at least one more six-month audit (through June 30, 2008) before shifting to quarterly reviews. The long-term area drought has created additional workload for CMU staff in general, and specifically, staff has been formulating a contract amendment to address the budgetary effects, which Internal Audit has agreed to review. As of month-end July, the FY09 optimized budgets for Lift Stations and WWOP have not been received for Audit's review.
  - **Street Maintenance:** The MOU period ended June 30, 2008. We are wrapping up the third quarter (March 31<sup>st</sup>) audit and will begin the final quarter and year-end audit thereafter.
2. **CATS Construction and Operations** – With CATS increased funding (now two FTE), audits of the South Rail Line construction projects will expand as previously intended, and operational audits will be added, to include cash handling for both buses and light rail. CATS' management

has asked Internal Audit to contract with an outside firm to conduct a performance audit of CATS' construction and design controls, procurement of rail cars, budget and schedule variances and communication. We will be on an aggressive timeline to complete this effort by year-end.

3. Procurement Follow up – In response to the Internal Audit report and Matrix Review, City-wide procurement efforts are expanding. Specifically, PSD is working with KBUs to identify procurements which would benefit from city-wide purchasing efforts. In addition, a City-wide construction contracting manual is being developed with Charlotte Mecklenburg Utilities and Engineering and Property Management KBUs taking the lead. Further, staff is receiving training to comply with the June 2007 procurement policy and additional recommendations are being studied. Two KBU-specific audits have been completed for Aviation and CATS. Internal Audit will work with the remaining larger KBUs (BSS and at least three additional KBUs) to schedule and complete their reviews in a timely manner.
4. Electronic Workpaper Implementation – Audit staff will change the way we work and set the groundwork for greater efficiencies in the future with the use of on-line workpaper preparation, supervisory review, and more detailed audit planning. A risk analysis module is also available and is being populated for future use.
5. Initiate Control Self Assessment – While expanding our breadth beyond competition to more non-competition areas in the past three years, there are numerous areas in the City that could benefit from an examination of their internal controls. One approach to obtaining broader coverage is to coordinate "self assessments." Audit staff needs to be trained and a pilot project needs to be identified.
6. Respond to requests for investigations – In the past few years, several special investigations were requested and completed, indicating that Internal Audit has been recognized as a resource to assist management's need to address control weaknesses and allegations of improprieties. While we cannot project the timing or extent of effort which will be required, we know from past experience that these needs require an immediate and concentrated response to meet the needs of the KBUs when they arise.

## **Overview**

The 2009 Audit Plan includes existing commitments to complete audits related to the City's managed competition efforts. The Plan also details audits in progress, regularly scheduled audits and additional efforts under consideration for the coming year.

Managed Competition Audits:

Managed Competition requires Internal Audit involvement with the following:

- a. Solicitation for proposals to ensure a level playing field;
- b. Accuracy of the City's proposed costs for delivering services;
- c. Financial reviews of proponents to help determine their ability to perform;
- d. Validating the City's actual costs and any gainsharing; and

- e. Compliance with financial and non-financial aspects of service agreements.

In addition to agreements reached with City units through the managed competition efforts, the City has optimized certain services by extending lessons learned through competition to similar operating units. Those optimization agreements also require monitoring and verification of the City's costs before any applicable gainsharing is approved.

Competitions that are won by private enterprise also need to be monitored for compliance with financial and non-financial contract requirements. While the primary responsibility for this monitoring rests with the Key Business Unit, Internal Audit provides overall reviews and assistance, as determined necessary or as requested.

Overall, the number of managed competition contracts has been decreasing. However, those in place have increased in size and complexity. Specifically, active optimization agreements have increased with the extension of existing agreements within the Utilities KBU. Since its development in 2005, the Audit Division has continued to update an "Audit Guide to Managed Competition and Optimization" to assist those preparing bids and updating annual optimization budgets. We continue to receive input from all KBUs that are significantly involved in managed competition, and the ongoing use of the guide should help improve the overall efficiency of the process.

While managed competition activities continue to demand attention during bids, optimization budget updates, and quarterly reviews, staff efficiencies have improved over time, especially with the use of electronic workpapers which have streamlined the repetitive audits. Audit staff time allocated to managed competition has declined to about one-third, and is projected to decline further in the coming year, as the Street Maintenance contract concludes.

#### Non-Competition (Performance) Audits:

Over the past several years, the Audit Division has increased its emphasis on non-competition audits as staff has been added, including two CATS-funded positions. About two-thirds of Audit staff time has been allocated to non-competition activities. These include: CATS construction-related audits (other direct costs, labor, overhead); Accounting and Finance operations (accounts payable, revenue collections) and citywide activities (e.g., procurement and purchase order processing). A number of smaller audits are also conducted regularly, including Vice Imprest reimbursements, Accounts Receivable write-offs, Annexation reviews (Volunteer Fire Department and Private Waste Haulers economic loss calculations), and financial capability reviews for bidders.

It is expected that the City Manager's Office and KBEs may make special requests for audits or other support. Some time will be available for such requests, while on other occasions it may be necessary to delay a scheduled audit to address a newly identified need.

## Internal Audit Division Staffing

The Division consists of the Manager, four Senior Auditors and four Staff Auditors. Six auditors are CPAs and also have attained the Certified Internal Auditor designation. (Two staff members have completed half the CIA requirements.) Part-time contractors provide assistance as needed.

## Brief Review of FY 2008

The Internal Audit Division completed a challenging schedule of managed-competition and other performance audits. Significant efforts were made to review the City's procurement policies and procedures, and to support CATS light rail construction.

Internal Audit staff time was allocated about 35% to competition-related work, including 19 quarterly and semi-annual audits of Street Maintenance, Solid Waste Services (three districts), Vest Water Treatment Plant, Irwin Wastewater Treatment Plant and Wastewater Lift Stations; along with five competition or optimization budget reviews.

Sixty-five percent of Audit staff time was used to complete 12 non-competition audits and to coordinate an outside firm's work, in the following categories:

- 5 Accounts Payable, Procurement and Revenue Operations
- 3 CATS Construction
- 2 Other CATS
- 1 Information Technology
- 1 Vice Imprest
- 1 Contracting support financial reviews

Staff continues to transition to using Electronic Workpaper Software. Workpaper documentation and quality control has improved, and efficiencies should become apparent over the coming year. Training by more experienced staff accompanies the transition.

## Initiatives Planned

- A. Continue implementation of Electronic Workpaper Software ("PAWS"), as described in Priorities section (#4).
- B. Complete implementation of Peer Review recommendations. The GAO's Auditing Standards recently began to require an independent outside peer review at least every three years. The City of Charlotte's Internal Audit Division completed this requirement in February 2008. Most of the recommendations were implemented immediately, including an update of office policies and a sign-off of an updated Audit Charter by the current City Manager. The peer review team also recommended that regular audit summaries be distributed to our governing body (City Council), and the City Manager agreed to forward our summaries on a semi-annual basis. The FY08 Summary will be completed by August.
- C. Audit of CATS Cash Handling (existing bus and future light rail operations), as mentioned in Priorities section (#2).

- D. As noted in the Priorities section (#2), CATS' management has asked Internal Audit to manage the selection of a Service Provider and subsequent efforts to conduct a performance audit of CATS' construction, design and budget control.
- E. Initiate Control Self Assessment pilot program, as noted in Priorities section (#5).
- F. Maintain or improve competition report turnaround. Some of our quarterly managed competition audits have slipped from the desired turnaround cycle. We are going to add staff levels required for each audit to attempt an eight-week turnaround, i.e., approximately 2 months after the monitoring report is received.

### **Resource Allocation Summary**

Our use of contractors (#199) has been fairly steady for the past three years, with most of the increase a result of funds supplied by CATS, which have been transferred from salaries to 199. CATS does not have a preference for how we meet our commitment for auditing operations and construction (with an emphasis on the South Rail Line). We have chosen to lean more heavily on contracted resources in the past, but are converting one of the contracted staff positions to an employee. The open position has been filled, with a new staff person beginning in late July 2008.

CATS has committed to an increase of funding to Internal Audit to achieve two FTE. We intend to increase our audit of construction contracts and begin a review of cash handling and other operations. In the past, we have been unable to meet CATS' request for audits of bus operation cash handling. With the addition of Light Rail operations, the need to address this operational aspect has been raised further.

We have used contracted staff at a rate of 2 to 2-1/2 FTE for the past three years. To maintain this level and make minimal progress on achieving our Planned Initiatives, we need funding to maintain 10.5 FTE through a combination of employees and contracted staff. Almost our entire \$35,800 request for additional resources to cover increased contractor rates was funded.

With the addition of staff, and a continued emphasis on staff achieving professional certifications, it has become more important for staff members to obtain required Continuing Professional Education (CPE). In addition, our more experienced staff has begun to take leadership positions on the committees of our professional organizations, which in turn require attendance at certain conferences. Our allocation of funds for travel and training has not kept up with these requirements; however, we will be as creative as possible to minimize the cost of covering these requirements.

In March 2008, the City Auditor began performing volunteer instructor assignments with the Institute of Internal Auditors. While no direct remuneration is received, the City receives a credit equal to the hours served that allows anyone in Internal Audit to attend an equal number of CPE courses conducted by the IIA. In FY08, the City Auditor obtained 70 hours credit with a minimum direct value to the City of \$3,200. One staff auditor has already registered for

(December 2008) courses that otherwise would have cost \$1,800 (using 39 hours of credit). We will utilize the credits received as efficiently as possible to minimize total CPE costs. However, there is no guarantee that the City Auditor's schedule and the IIA's needs will continue to match at the current level, i.e., we can't count on 70 hours credit per year.



# KBU-Balanced Scorecard Report

Reporting Period: July 1, 2008 to June 30, 2009

Corporate Objective	KBU Initiative (* indicates Focus Area Initiative)	Measure (\$ indicates incentive pay measure)	Prior Year Actual	Lead or Lag	Performance Data			Comments/Explanation <i>(To be completed at mid-year and year-end reporting)</i>
					Target	YTD	Status	

<b>Run the Business</b>	B1. Develop Collaborative Solutions	Develop and adopt an Annual Audit Plan to implement the Strategic Audit Plan.	Develop and adopt and Annual Audit Plan	n/a		July 31, 2008			
		Develop and adopt a multi-year Strategic Audit Plan aligned with Citywide priorities and Key Business needs.	Adoption of multi-year Strategic Audit Plan with the period of coverage expanded by one year.	n/a		Dec. 31, 2008			Plan to be developed and adopted by December 31, 2008 will be a two-year plan for FY09 and FY10.
	B3. Optimize Business Processes	Identify audit processes and opportunities where current operations and procedures can be improved.	Receive results of Assoc. of Local Government Auditors peer review and implement recommendations			(See comments section)			Target: Implement the immediate actions by December 31, 2008, review and complete annual actions as recommended.  Note: Peer reviews are conducted every three years. Some recommendations will require immediate implementation while others will require annual actions
		Research Control Self-Assessment program for possible implementation.	Initiate Control Self-Assessment pilot program			March 31, 2009 (see comment section)			Target: Complete study and set plan to initiate a Control Self-Assessment pilot program by March 31, 2009. Target date to complete pilot program will be set later)
		Implement electronic work papers and expand usage of additional software modules	Use of electronic work papers, planning and time control modules, and risk analysis			Dec. 31, 2008 (see comment section)			Targets: 1.) Each audit initiated in Pentana Electronic Workpapers with an assessment of a minimum of three controls and three risks by Dec. 31, 2008, 2.) Complete an annual review of the global risk assessment by June 30, 2009
	Manage Resources	R2. Deliver Competitive Services	Conduct independent and objective appraisals of the City's system of internal controls, the efficiency of operations and the effectiveness with which these functions are managed.	Number of Performance (non-competition) audits completed			Twelve (12)		
Improve managed competition report turnaround schedule.			Number of audit reports issued within 3-month turnaround,			50%			
		Number of audit reports issued within 2 months of competition group's completion of monitoring reports			25%				

\* in KBU initiative column indicates Focus Area initiative  
\$ indicates incentive pay measure

# KBU-Balanced Scorecard Report

Reporting Period: July 1, 2008 to June 30, 2009

Corporate Objective	KBU Initiative (* indicates Focus Area Initiative)	Measure (\$ indicates incentive pay measure)	Prior Year Actual	Lead or Lag	Performance Data			Comments/Explanation <i>(To be completed at mid-year and year-end reporting)</i>
					Target	YTD	Status	

<b>Develop Employees</b>	E1. Achieve Positive Employee Climate	Support Physical Activity	% participation in group activities of at least four week duration each (\$)			75%			
			Promotion of physical activity (\$)			Regular staff meetings			
	E3. Promote Learning and Growth	Promote "Certified Internal Auditor" designation	% CIA attainment by staff			100% by June 30, 2009*			*Or within 2 years of employment for new staff
		Achieve continuing professional education (CPE) requirement	100% CPE required for all staff			Maintain 100%			

**Status:**

1. Use a "+" (plus) sign to indicate all is well.
2. Use a "-" (minus) sign to indicate that the status is not where expected or the current status is in trouble. Provide explanation.
3. Use a "x" to indicate this target will not or is not met. Provide explanation.