

**CITY OF CHARLOTTE
CITY MANAGER'S OFFICE – INTERNAL AUDIT DIVISION**

MEMORANDUM

To: Budget & Evaluation
From: Greg McDowell, City Auditor
Re: Internal Audit – FY10 Strategic Operating Plan

July 29, 2009

Priorities for 2010

1. Managed Competition – The City's established program relies upon Internal Audit's timely support and completion of regular audits. We issued 18-20 quarterly or semi-annual audit reports in each of the past two years, in addition to optimization budget reviews which are completed in the May to July time frame. We expect to issue a similar number in FY10 as we replace some quarterlies with semi-annual reports to reduce the total audit time, and to work around KBU staff conflicts such as the annual budget preparation period.

Solid Waste Services is restructuring with a new approach to take effect in July 2010. SWS will expand garbage collection across the city by taking over the West District, which is currently contracted to Inland Services. At the same time, all recycling services will be contracted out to a new provider. During 2010, Internal Audit will continue to support SWS' managed competition (optimization) commitment with quarterly audits. We have recently completed the audits of SWS' optimization budgets and are finalizing plans to conduct annual reviews of the restructured SWS, as the PCAC and Council Restructuring Government Committee comment on necessary monitoring/reporting.

Within Utilities, one audit (the initial 4 plant optimization) started slowly and has been audited only through June 2008. We are conducting 6-month audits and will switch to quarterly after the audit cycle time decreases. In addition, Utilities added a Locates contract which began July 2008. The first audit through December 2008 was completed, but held until we could present the findings to CMU management. With the economic downturn in late 2008, the projected number of locates did not materialize, causing the contracting unit to operate at a loss. The audit report will be issued in late July and CMU is prepared to respond.

2. American Recovery and Reinvestment Act (ARRA, or Stimulus Funds) – The City Manager requested Internal Audit's assistance with ensuring accurate reporting of Funds. Initially, we focused on the City's preparation to meet stringent Federal and State reporting requirements. We have issued several memorandums related to these requirements. The City will be using an application called MS360 for tracking and reporting of Stimulus Funds. In August, when the City conducts a "trial-run" using the system, we will evaluate the reporting process, and check KBU data for compliance. Quarterly reporting will extend for a few years, and Internal Audit will continue to review the processes and accuracy related to the various KBUs' reports. Audits in 2010 should concentrate on the procurement processes followed, while 2011 audits will address contract and grant management efforts. Issues identified by

the GAO and various Inspectors General may also impact our plans, as we attempt to address risks which become apparent over time.

3. Follow Up Procurement Efforts – In the past two years, Internal Audit has responded to the City Manager’s request for an overall procurement review, which included the hiring of a consultant and a number of audit follow-ups. The reviews of these past efforts will be completed in FY10. Internal Audit will assess the numerous past recommendations and any additional efforts in this area will be outlined. Our approach for 2010 (and possibly into 2011) will be to continue with the following:
 - *KBU-specific* procurement follow-ups – Aviation was completed in FY08. CATS, BSS and Fire were completed in FY09, with Utilities in progress at year-end. At least two more KBUs will be reviewed in FY10. In addition, two of the first five KBUs audited require limited-scope reviews to determine that recommended control improvements have been put in place.
 - Internal Audit contracted with Matrix Consulting and presented the service provider’s recommendations to Council in May 2008. We are assessing the actions taken in response to the top three recommendations: expansion of city-wide procurements under the direction of BSS/PSD; development of a city-wide construction contracting manual; and improvement of procurement-related technology capabilities. We will complete this assessment and also determine whether additional Matrix recommendations should be addressed.
 - P-Card – Previous reviews of the City’s use of Credit Cards for Procurement (P-Cards) have shown strong controls to be in place. However, P-Cards can be abused and should be audited regularly to ensure that City policies are followed. A new Sharepoint process is being implemented, and we will conduct an audit after it is completed. The audit could start in late 2010 or early 2011.
4. CATS Construction and Operations – Five individual audits were in various stages of progress at year-end. At our request, CATS has issued letters to two South Rail Line sub-contractors related to audit inquiries for direct labor, overhead and contract fee audits. One of the five also informed us of a past error which led to inflated overhead rates, and we are in the early stages of resolving that issue. Separately, we are preparing to address questions raised by our audit of other direct costs (ODCs) for STV’s 2007 billings. During 2010, we will initiate audits related to the Northeast Corridor (Blue Line Extension) design work. Also, we hope to expand our audit efforts as previously intended, to include reviews of cash handling for both buses and light rail.
5. Initiate Control Self Assessment – While expanding our audit scope beyond competition to more non-competition areas in the past three years, numerous areas in the City still 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. As noted in our mid-year challenges report, this effort has

been delayed due to the expansion of existing projects, along with staffing issues resulting from budget adjustments.

6. Respond to Requests for Investigations – Several special investigations were requested over the past few years, indicating that Internal Audit has been recognized as a resource to assist management's need to address allegations of improprieties. While we cannot project the timing or extent of effort which will be required, we know from past experience that these investigations require an immediate and concentrated response to meet the KBUs' needs when they arise.

Overview

The 2010-2011 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 years.

Managed Competition Audits:

Overall, the number of managed competition contracts has been decreasing. However, those in place remain significant. 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, and the ongoing use of the guide should help improve the overall efficiency of the process.

Non-Competition Audits:

Over the past several years, the Audit Division has increased its emphasis on non-competition audits as staff has been added. Just over two-thirds of Audit staff project 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 city-wide 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 (three permanent, one part-time temporary) 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 examination requirements.) Part-time contractors provide assistance as needed. With the retirement of one senior and his planned return as a temporary employee, the resulting salary reduction will offset the required FY10 budget reduction. Current contractors will be retained at levels of effort similar to 2009.

Brief Review of FY 2009

The Internal Audit Division has completed a number of managed-competition and other performance audits during fiscal year 2009. Significant efforts were made to follow up on previous procurement audits, and to support CATS light rail construction. Near year-end, we began supporting the City's efforts to prepare for the receipt and proper reporting of American Recovery and Reinvestment Act (ARRA), or Stimulus Act funds.

Internal Audit staff project time was allocated about 32% to competition-related work. These efforts included 18 quarterly and semi-annual audits of Street Maintenance, Solid Waste Services, Vest Water Treatment Plant, Irwin Wastewater Treatment Plant, the new Wastewater Optimization Plants (McAlpine, McDowell, Mallard and Sugar Creek) and Wastewater Lift Stations. Four optimization budget reviews were also completed.

Sixty-eight percent of Audit staff project time was used to complete thirteen non-competition audits and to coordinate two outside firms' work (related to special projects requested by CATS) in the following categories:

- 4 Procurement and Accounts Payable Follow-ups
- 4 CATS-Related
- 2 Annexation
- 2 Park-It and Burglary Alarm Write-offs
- 1 Tax Transfers
- 1 Police Vice
- 1 Enterprise Resource Planning (ERP) Readiness

Initiatives Planned

- A. Support the transition of SWS managed competition, if it develops as proposed, i.e., with the change from service by district to city-wide services. Add resources to Utilities' audits until the audit cycle is reduced to a 3-4 month range. (See Priorities Section, #1.)
- B. Support the City's Stimulus Fund (ARRA) reporting requirements and develop related audits as guidance from the OMB and Inspectors General is received. (See Priorities Section, #2.)
- C. Complete additional KBU-specific procurement follow-up audit and summarize all results, along with an update to the Matrix report presented to Council in May 2008. (See Priorities Section, #3.)
- D. Summarize questioned costs and recoveries from CATS construction audits, and assess remaining audits to be completed which relate to the South Corridor Blue Line. (See Priorities Section, #4.)
- E. Renew efforts to initiate "Control Self-Assessment." (See Priorities Section, #5.)

Resource Allocation Summary

Internal Audit was fully staffed at 8-3/4 FTE in 2009, until the retirement of an audit senior. With his return as a temporary employee, the resulting salary reduction will offset the required FY10 budget reduction. Current contractors will be retained at levels of effort similar to FY09. We have used contracted staff at a rate of 2 to 2-1/2 FTE for the past four years.

After filling an open position in July 2008, we were funding three contractors. However, the funding restrictions in October 2008 caused us to terminate one contractor and reduce the use of the other two. The reduced use of contractors was addressed by performing more managed-competition audits in-house. It also reduced flexibility in staffing and slowed our responsiveness. The turnaround on some managed competition audits grew beyond our 3-4 month goal. SWS audits slipped as we diverted staff to support SWS' reorganization plans. New audits at CMU required additional time as some CMU staff began working on managed competition programs for the first time and audit staff was strained in our attempts to support their needs. In addition, the annual optimization budgets must be completed early in the fiscal year for them to remain credible. The FY09 budgets were completed in September and October 2008. We worked with SWS and CMU to schedule completion of the FY10 budgets earlier. Two are being completed in July with the remainder in August. However, to accomplish this improved timing, it was necessary to replace some quarterly audits with semi-annuals.

With the addition of staff over the past few years, and a continued emphasis on achieving professional certifications, it has become more important for staff members to obtain required Continuing Professional Education (CPE). Recent GAO (Yellow Book) pronouncements require an average 40 hours CPE per person to remain in compliance with Government Auditing Standards. 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. We are being as creative as possible in the use of training funds. The Audit Manager obtained 70 hours credit from the Institute of Internal Auditing after teaching classes for the organization. Three staff members each were able to participate in 2-day classes held by the IIA in Charlotte in January 2008 at no expense, using these credits. However, there is limited availability of local courses, and it is more likely that the use of the remaining credits will require travel to Raleigh or Atlanta.

Charlotte was selected Host City for ALGA's 2011 conference, which will attract over 200 auditors from across the nation. Due to budget restrictions, we were able to send only one auditor to the 2009 conference. We will attempt to fund the usual two attendees in 2010.

In 2010, the IIA's international conference will be held in Atlanta, presenting an infrequent opportunity for staff to attend this event, which provides CPE and the unique opportunity to meet auditors from wide and varied backgrounds. The past two conferences were held in San Francisco and Paris. We will attempt to fund at least two staff members, at a cost of about \$1,800 per person.

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