

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

***MEMORANDUM***

To: Budget & Evaluation  
From: Greg McDowell, City Auditor  
Re: Internal Audit – Strategic Operating Plan FY11

July 23, 2010

**Internal Audit Purpose/Goals**

Internal Auditing is an independent appraisal activity established to conduct reviews of the City’s system of internal controls. The primary objective of Internal Audit is to provide reasonable assurance that the City has an operating and effective system of internal controls. A secondary objective of Internal Audit is to assist members of management in evaluating the efficiency and effectiveness of operations.

This document provides an explanation of our strategy for FY11.

	FY2009	FY2010	FY2011
Budget	\$900,498	\$905,847	\$903,274
Positions	9	9	9

**Introduction**

Internal Audit has managed to its budget despite increased demands and a flat level of resources. The ability to achieve these results is due to the benefits gained through a stable workforce, increased efficiencies via electronic workpapers implemented over the past two years, and effective audit management by senior audit staff members. To maintain flexibility, we did not fill an open position in FY10. Instead, we chose to increase our use of audit contractors where appropriate.

Our efforts are being impacted by the following issues:

- **Unplanned Projects** – The Internal Audit Division welcomes the opportunity to respond to the needs of the City Manager’s Office and KBE requests. Often, these unforeseen projects are of such importance that planned audits are delayed to accommodate them. In FY10, we conducted an investigation for CATS which may also result in legal proceedings and testimony by Audit staff in the coming year. Audit staff provided guidance related to ARRA and reviewed the reporting input of several City departments. Auditors supported SWS’ reorganization, adapting future audit plans to the changing needs of a KBU. A CMU unit under managed competition entered a Cure status, requiring specific audit support. Late in FY10, the City Manager’s Office requested Internal Audit’s review of a procurement matter and a Utilities Meter Reading issue. In each case, the Audit Division re-prioritized its work and provided the necessary support.

- Complexity – certain audits have required extensive meetings, follow-up and briefings of senior staff; e.g., County Property Tax Collections, ARRA and CATS construction.
- Follow-up – after conducting six KBU-specific procurement audits, we found that two require additional limited reviews to ensure recommendations have been implemented.
- Administrative Challenges – some of the KBUs we have worked with are facing their own issues with limited staff; our audits necessarily require interaction to address controls and respond to recommendations (due to these realities, we have suspended planning efforts to facilitate Control Self-Assessments, as described in the prior SOP and Audit Plan). The unplanned reduction by CATS in the past year raises the need for Internal Audit to move away from its past funding model. For budget stability (and necessarily, to maintain professional independence related to CATS' audits), we will be requesting that B&E help us develop a stable budget which does not rely upon unilateral budget decisions made by other KBUs.
- Internal Staffing – a long-time employee retired and a recently vacated position has been left open, to maintain budget flexibility. We have replaced some of this resource deficiency by bringing back the retiree as a temp, and increasing the use of outside contractors.

## **Overview**

The 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 later years.

### *Managed Competition Audits:*

Overall, the number of managed competition contracts has been decreasing. However, those in place remain significant. In 2005, the Audit Division completed an "Audit Guide to Managed Competition and Optimization" to assist those preparing bids and updating annual optimization budgets. We received input from all KBUs that are significantly involved in managed competition, and the use of the guide should help improve the overall efficiency of the process. The Guide was updated for use in 2007.

### *Non-Competition Audits:*

Over the past several years, the division of audit time has moved from a 90% allocation to Competition audits to a more balanced one. Staff time in FY 2009 was allotted 68% to non-competition audits. Our goal is to achieve a 75-25 allocation of resources, and we reached a 70% allocation to non-competition audits in FY 2010.

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.

## **Priorities for 2011**

1. **Follow up Procurement Efforts** – In the past three 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. Six KBU-specific audits were completed between May 2008 and December 2009. An interim update was provided to the City Manager in December 2009. A final report had been planned for FY 2010 but was delayed as we focused on other priorities – some which were procurement-related. Also, two of the original six KBUs audited require a limited follow-up review to assess actions taken in response to specific audit recommendations. Such a follow-up for BSS was nearly complete at year-end, while a similar review for Utilities was being planned. We will continue with procurement and contract-related audits in FY11, and provide a summary of results at appropriate intervals. FY11 efforts will include a review of the City’s use of credit cards for procurement (P-cards).
2. **ARRA** – Four quarterly reporting periods have passed, with the City achieving a very high accuracy. ARRA Federal Reporting has required significant audit resources to review and address compliance with ARRA directives. We now have reasonable templates and checklists available for project managers to perform self audits of their data, reducing the need for Internal Audit to perform detailed reporting reviews. Audit will continue to monitor and provide updates to future changes in ARRA requirements. Auditors will work to ensure quality is maintained by performing audits on a sample basis, focusing on those entities which have exhibited difficulties in the past. Our reduced focus on detailed reporting will allow us to conduct reviews related to ARRA-required procurement activities. As time allows, we also plan to expand our review efforts to include grant management efforts.
3. **CATS Construction** – While the South Rail Line has been operating for over two years, necessary audits related to construction continue. We have issued reports focusing on light rail subcontractors PBS&J and Odell, along with an investigation related to allegations made by DEW for its subcontract work to Mass/Aldridge (MAJV). The audits of CATS contractors have been prolonged due to the lack of vendor responsiveness to audit inquiries and requests for additional information.

In September 2009, we recommended disallowances of more than \$196,000, or about 4% of PBS&J’s billings of direct labor, overhead and fees. The audit was resolved with CATS’ acceptance of \$174,145 from PBS&J in April 2010. The January 2010 Odell audit report was finalized using estimates of results for the limited data provided by Odell, as the company was non-responsive to our requests for additional data after we found errors in the first round of sampling. (The report recommended disallowances of nearly \$182,000, or about 10% of direct labor, overhead and fees. Odell has requested Internal Audit’s documentation, which will be provided in August.)

Disagreements related to interpretation of Federal Acquisition Regulations (the FAR) are common. Unresponsiveness creates delays and requires additional audit work. The recommended disallowances require follow-up to determine CATS’ handling of the claims. We are assessing the remaining workload related to the South Rail Line. Also, we are

beginning planning efforts related to expenditures being made for the North and Northeast rail line studies.

4. Managed Competition – The City's established program relies upon Internal Audit's timely support and completion of regular audits. There were seven active contracts in FY10. Six have been audited through March 2010 and are considered current. The seventh will have its March 2010 audit completed in late July and is also considered current, due to its size and complexity. The timeliness of all managed competition audits has improved as additional resources were focused on certain issues, and CMU provided more timely responses. The delays had been due to both the complexity of the multi-unit \$20 million operation (four treatment plants), and some difficulties CMU staff had in administratively supporting the contract.

Solid Waste is undergoing a transition to roll-out recyclables and plans to take all non-recycling activities in-house (i.e., adding the West District) effective July 2010. We continue to audit the North, South and East Districts in order to maintain reliable benchmark data. After completing individual audits of the three Districts for the remaining quarter (through June 2010), we will begin performing a combined audit of SWS operations (all non-recycling pick-ups). We will conduct the audit quarterly throughout FY11, but move to semi-annual to reduce the commitment of audit resources, subsequently. (Based upon the PCAC-approved approach, Internal Audit will assess the initial SWS budget, based upon its proposals and current audited results.

5. IT Reviews – Audit staff has performed limited reviews of IT-related issues. In FY 2009, we completed an Agreed-Upon Procedures review of the City's Enterprise Resource Planning (ERP) Readiness. As the City continues to plan IT acquisitions (including a Financial and Procurement system), we will work with the OCIO to identify areas in which Internal Audit can contribute. Initially, we are studying controls and processes that should be built into a new ERP.
6. Tax Revenue Reviews – In December 2009, we completed a review of Property Taxes Received from the County. A separate audit of Prepared Food and Beverage Taxes is in progress. While there are potential difficulties in conducting an audit of a related municipality's operations, we have effectively developed a working relationship to address the accuracy of the many revenue sources which flow through the County to the City. We will continue to assess the risks related to various sources, and explore effective means to assure that the City's revenues are received in an accurate and timely manner.
7. Annual Commitments and Responsiveness – Internal Audit has committed to several repetitive audits. While none alone is as significant as the Priorities outlined above, a number of KBUs have come to rely upon our efforts. These include five to six Vice Imprest audits per year and requests for delinquent account receivable write-offs from several organizations. Bi-annually, we audit the economic loss payments to waste haulers and volunteer fire departments related to annexation. Each year, we conduct an audit of CATS' bus operations which we submit to the City's outside financial statement auditors. In addition, we are responsive to several requests for financial reviews related to vendors the

City might do business with (for financial capability), and an occasional investigation, e.g., regarding alleged theft or impropriety. Internal Audit considers it a priority to respond to each such request in a timely manner.

### **Resource Allocation Summary**

We are staffed at 6-3/4 FTE, with one part-time temporary adding 1/2 FTE. Two positions are open, although the part-time temporary is funded by most of one open position. We have used remaining funds to supplement our contractor resources. Our use of contractors has been fairly steady for the past few years. We have used contracted staff at a rate of 2 to 2-1/2 FTE for the past several years.

In 2009, CATS was under severe budget pressures and decreased its previously committed funding for two audit positions. If any additional reductions are made, we will struggle to maintain our level of service and we will be unable to fill an open position.

The ARRA (Recovery Act, i.e., Stimulus) of 2009 emphasized the importance of transparency and accountability at all government levels. In order to perform audits in compliance with government standards, each staff member is required to obtain 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 members have 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. In 2008, 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 2009 at no expense, using these credits. Most of the remaining credits from 2008 will be used in place of a conference fee of about \$1,000. The Manager earned an additional 32 hours in 2010 which must be used before they expire in 2012. While the IIA's staffing needs are uncertain, the Manager will be available to teach approximately once yearly. Any earned credits can be used to supplement the Audit Division's training budget.

Charlotte was selected Host City for the Association of Local Government Auditors' (ALGA's) May 2011 conference, which will attract over 200 auditors from across the nation. Normally, we send two staff to the annual conference. As hosts, we will be able to have each staff member participate. While a commitment of resources is required, the opportunity is unique and should provide significant professional growth for the Audit Division.

glm