

**City of Moore**

**Internal Audit Report on Design and Operating  
Effectiveness of Internal Controls over CDBG-  
DR Transactions**

**April 2017**



**H O R N E**

CPAs & Business Advisors

## I. Executive Overview

### **Introduction**

We recently completed a review of functions outlined below with a primary objective of evaluating the process and significant control points for effectiveness, adequacy, and efficiency of operations for the CDBG-DR processes performed by City of Moore (the "City"). The audit was conducted in accordance with the terms of our engagement letter and applicable internal audit guidelines. This report is intended solely for the information and use of management and the City Council, and should not be used for any other purpose. The City's oversight authorities may be provided with a copy of this report in connection with fulfilling their respective responsibilities.

It is important to note, we recognize the City of Moore's responsiveness to issues reported through the internal audit process. The City has appropriately allocated resources, attention, and brought on new staff to resolve these issues which have led to improvement in compliance practices. Furthermore, the City has demonstrated diligence in working to resolve high-risk issues by conducting proactive communication with the HUD Field Office to seek direct guidance as well as request technical assistance.

### **Audit Scope**

We completed an audit of several functions of the City's CDBG-DR program in accordance with the terms of our engagement letter. The audit period covered September 1, 2016 through January 31, 2017. The functions covered in our audit for this period are outlined, as follows:

- Program policies and procedures (focus on Section 3)
- Financial management internal controls
- Eligibility of cost and procurement method

Our procedures were performed to:

- Evaluate the adequacy of internal controls in place to mitigate the identified risks,
- Evaluate the allowability of transactions,
- Evaluate newly developed policies and procedures as well as changes to policies and procedures following the October 2016 audit.

To accomplish this, we performed the following:

- Interviewed key personnel in each function's area

- Tested a sample of CDBG-DR financial transactions for the period September 1, 2016 through January 31, 2017 (the “testing period”)
- Tested procurement actions for Rudy Construction and Silverstar Construction for adherence to regulatory requirements and applicable policies and procedures
- Reviewed the following documents:
  - Procurement file for Rudy’s Construction and SilverStar Construction
  - Reconciliations between the Project Ledger and General Ledger for May 2016
  - Documentation of leveraged payroll costs
  - Section 3 vendor training materials
  - Section 3 reporting submitted during the testing period
  - Davis-bacon reporting submitted during the testing period
  - City of Moore CDBG-DR Policies and Procedures
  - City of Moore Section 3 Plan
  - Financial documentation and evidence of minimum financial controls for sample selection expenditures

It should be recognized that controls are designed to provide reasonable, but not absolute, assurance that errors and irregularities will not occur, and that procedures are performed in accordance with management's intentions. There are inherent limitations that should be recognized in considering the potential effectiveness of any system of controls. In the performance of most control procedures, errors can result from misunderstanding of instructions, mistakes in judgment, carelessness, or other personal factors. Control procedures can be circumvented intentionally by management with respect to the execution and recording of transactions, or with respect to the estimates and judgments required in the processing of data.

Further, the projection of any evaluation of control to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions, and that the degree of compliance with procedures may deteriorate.

### **Overview of Issues**

During the course of our work, we discussed our findings with management. Our detailed findings and recommendations for improving controls and operations are described in the detailed issue matrix in Section I of this report. A separate listing of general enhancement opportunities not considered to be findings is described in section II of this report.

A summary of key issues is provided below along with the following information:

- Relative Risk is an evaluation of the severity of the concern and the potential impact on the operations. Items rated as "High" are considered to be of immediate concern and could cause significant operational issues if not addressed in a timely manner. Items rated as "Moderate" may also cause operational issues and do not require

immediate attention, but should be addressed as soon as possible. Items rated as "Low" could escalate into operational issues, but can be addressed through the normal course of conducting business.

- Resolution Level of Difficulty is an evaluation of the estimated level of difficulty and potential cost to resolve the concern based on our experience. Items rated as "High" are considered to be difficult to resolve and/or will require a significant amount of planning and management involvement/oversight in order to obtain resolution. Items rated as "Moderate" are not as difficult to resolve and/or do not require a significant amount of planning, but may be time-consuming to resolve. Items rated as "Low" are items that are not complex and/or do not require significant amounts of planning and time to resolve.

<b>Summary of Results</b>				
<b>Issue Description</b>		<b>Page</b>	<b>Relative Risk</b>	<b>Resolution Level of Difficulty</b>
2016-4-1	*Noncompliance with required reporting elements of Section 3 Plan	6	High	Moderate
2016-4-2	Potential non-compliance with Davis Bacon	6	Moderate	Low
2016-4-3	Timely reconciliation of project ledger to general ledger	8	Moderate	Low
2016-4-4	Non-reimbursable expenses in general ledger	8	High	Low
<i>*Matter noted in prior period.</i>				

Opportunities for enhancement are described in Section II of this report.

## Conclusion

Audit ratings, as defined below, were assigned based on the identification of the key findings summarized above, as well as other less significant comments that can be addressed by management in the normal course of business.

<b>Ratings</b>	<b>Conditions</b>
<b>Satisfactory</b>	No significant issues noted. Controls are considered adequate and findings, if any, are not significant to the overall unit.
<b>Needs Improvement</b>	Some improvement is needed to bring the function to satisfactory status. If the deficiency continues without attention, it could lead to further deterioration and an unsatisfactory status.
<b>Unsatisfactory</b>	Significant deficiencies exist which could lead to financial loss or embarrassment to the City.

The following is a summary of the assigned rating for each function:

<b>Ratings</b>	<b>Conditions</b>
<b>Program Reporting</b>	Needs Improvement
<b>Program Design</b>	Satisfactory
<b>Internal Controls – Operating Effectiveness</b>	Needs Improvement

**I. Observations and Recommendations**

**Program Reporting**

Observation	Recommendation
<p><b>1. Noncompliance with required reporting elements of Section 3 Plan</b></p>	
<p>The following Section 3 reporting weaknesses are noted:</p> <ul style="list-style-type: none"> <li>• The reporting indicated a failure to meet the numerical goal regarding Section 3 employment and the City does not adequately address its or the contractor's best efforts in the endeavor.</li> <li>• The reporting provided does not appear to reflect other section 3 covered contract information accurately.</li> <li>• Documentation to support employment opportunities appears to support employee salaries paid by contractor as opposed to total household income as required by regulation.</li> </ul>	<p>We recommend that the City reevaluate its most recent Section 3 reporting and crosswalk to documentation that more accurately reflects current Section 3 status. Additionally, written procedural steps addressing the overall Section 3 reporting process and these identified weaknesses should be considered and addressed.</p> <p>Noncompliance with HUD's regulations in 24 CFR Part 135 may result in sanctions, termination of the Recipient's contract for default, and debarment or suspension from future HUD assisted contracts.</p> <p>(24CFR Part 135.38(F)).</p>
<p><b>Management Response:</b></p> <p>The City will update the Policies and Procedures to include a procedure on how to adequately document the efforts on reaching the Section 3 goals. The City will also ensure that documentation of the best efforts is maintained.</p> <p>The City will also ensure that it is clear to contractors that household income is required for Section 3 documentation. The City will update the Section 3 training to ensure that proper documentation is explained.</p>	

Observation			Recommendation																		
<b>2. Potential noncompliance with Davis Bacon requirements</b>																					
<p>Several contractors were noted as potentially compensating employees at rates lower than those required by Davis Bacon, as follows:</p> <table border="1"> <thead> <tr> <th>Project</th> <th>Contractor</th> <th>Observation</th> </tr> </thead> <tbody> <tr> <td>I-07-E-URG</td> <td>Rudy Construction</td> <td>John Bradford was classified as a Traffic Control: Flagger and the minimum rate of \$11.12 per OK150022. A study of all payrolls should be performed to determine if the wage restitution exists.</td> </tr> <tr> <td>I-14-E-URG</td> <td>Brewer Construction</td> <td>Miguel Murillo Troncoso appears to be paid less than the minimum rate.</td> </tr> <tr> <td>I-14-E-URG</td> <td>Baker Brothers</td> <td>Nathaniel Eastham's rate of pay was not included, so verification of pay rate could not occur.</td> </tr> <tr> <td>I-14-E-URG</td> <td>B&amp;B Sod/Bentley Turf Farms</td> <td>The following employees appear to be paid less than the minimum rate: <ul style="list-style-type: none"> <li>• Billy Sorrels</li> <li>• Martin Boyd</li> <li>• Tylor Hoey</li> </ul> </td> </tr> <tr> <td>I-14-E-URG</td> <td>Concrete Construction</td> <td>The following employees appear to be paid less than the</td> </tr> </tbody> </table>			Project	Contractor	Observation	I-07-E-URG	Rudy Construction	John Bradford was classified as a Traffic Control: Flagger and the minimum rate of \$11.12 per OK150022. A study of all payrolls should be performed to determine if the wage restitution exists.	I-14-E-URG	Brewer Construction	Miguel Murillo Troncoso appears to be paid less than the minimum rate.	I-14-E-URG	Baker Brothers	Nathaniel Eastham's rate of pay was not included, so verification of pay rate could not occur.	I-14-E-URG	B&B Sod/Bentley Turf Farms	The following employees appear to be paid less than the minimum rate: <ul style="list-style-type: none"> <li>• Billy Sorrels</li> <li>• Martin Boyd</li> <li>• Tylor Hoey</li> </ul>	I-14-E-URG	Concrete Construction	The following employees appear to be paid less than the	<p>We recommend that the City further review Davis Bacon reports, re-communicate the requirement and potential restitution implications to the Contractors to ensure compliance with the Act. Noncompliance with Davis Bacon requirements could eventually result in potential restitution costs to the City.</p> <p>(29 CFR Part 5)</p>
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<p>minimum rate:</p> <ul style="list-style-type: none"> <li>• Andrew Canales</li> <li>• Justin Cachero-Bayne</li> <li>• Jack Cezar, Jr.</li> <li>• Jeremiah Anderson</li> <li>• Liberio Trejo-Resendiz II</li> </ul> <p>All matters related to the Davis Bacon review are included in Appendix I.</p>	
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**Management Response:**

The City will review all construction project Davis-Bacon reports including concerns mentioned during the internal auditing and communicate deficiency items with the Contractors to ensure compliance with the Act. The review will be completed and communicate with contractors by May 26, 2017. The Contractors will correct concerns including restitutions and requirements to ensure compliance with the Act by July 31, 2017, or earlier.

**Internal Controls – Operating Effectiveness**

Observation	Recommendation
<b>3. Timely Reconciliations between the General Ledger and Project Ledger</b>	
While a process has been designed and procedure is being followed for a monthly reconciliation between the general ledger and project ledger, the most recently completed reconciliation was performed as of May 2016.	Management has made these reconciliations an area of emphasis and should continue to work to reconcile the ledgers on a current basis.

**Management Response:**

The City continues to prioritize the reconciliation of the general ledger and project ledger. Since the internal audit, reconciliations have been successfully completed through May 2017, and will be performed monthly hereafter.

Observation	Recommendation
<b>4. Non-reimbursable expenses in general ledger</b>	
<p>The City is not requesting reimbursement for fringe payroll benefits. These costs are recorded in Fund 15 and then transferred via journal entry to the general fund. Due to the implementation of Munis, the transferring journal entries have not occurred timely, leaving non-reimbursable expenses in Fund 15. While these costs are not material, they comprise a significant number of line items in Fund 15. There is a risk that reimbursement for these costs may be requested inadvertently and inclusion of these costs confuses the actual amount of reimbursement the City should expect.</p>	<p>We recommend the existing process of transferring these costs be simplified and streamlined to reduce the risk of improper reimbursement of costs.</p>
<p><b>Management Response:</b></p> <p>The city went live with payroll in Munis software in January 2017, which eliminated the need to work with project ledger in two different financial software. The work to provide support to the accounting department to remove unreimbursed payroll figures by journal entry is now being completed biweekly.</p> <p>The general ledger is not used as support for reimbursement requests. All requests for reimbursement of payroll and other expenditures are supported by project ledger reports.</p>	

**II. Enhancement**

Observation	Recommendation
<b>1. Section 3 Documentation Enhancements</b>	
<p>The Section 3 Plan provides form VDR-05-B, Self-certification which allows the employee to complete the form and self-certify their income states by selecting a wage range and number of persons in the household. The form, however, does not allow a new hire to select any income status unless they are a resident of the City of Moore. This can be very debilitating to an entity when low- and very low-income households are not prevalent.</p>	<p>We recommend the City consider revising the form to include income status for new hires living outside of Moore city limits.</p>
<p>The Section 3 Plan does not explain that HUD area median income values change annually and</p>	<p>The City should reference this information in their Section 3 Plan and either replace the</p>

<p>therefore, the annual income limits attested to by potential section 3 employees should change as well. This revision could allow for increased identification of Section 3 hires.</p> <p>Points are awarded to businesses that provide and qualify as a Section 3 Business Concern. However, formalized evaluation of pricing for Section 3 Business Concerns is not consistently included in the contractor interview process.</p> <p>Various reports included work classifications that did not match the wage determination for the applicable project. Work classifications, at times, were left to interpretation and therefore, the minimum wage rate could not be determined.</p> <p>Gross Wages and its applicable deductions and net pay should be reported on the certified payroll report. Some contractors are reporting deductions and net pay for the project hours only. If deducts are not taken out of the worker's pay, this should be noted.</p> <p>Support for "Other Deductions" should be provided by the Contractors.</p> <p>The signature contained on the certified payroll report should be from a principal of the company: an owner or officer or payroll administrator.</p> <p>Records of Employee Interviews should be reviewed in detail. Consideration of the observed worked and job duties and tools used as stated by the employee should be considered when determining whether their work classification matches the certified payroll report.</p>	<p>plan with updated forms annually or include the updated form on their website.</p> <p>Assuming all contractors possess the same qualifications, the contract should be awarded to the qualified Section 3 Business Concern provided their quote is no more than 10% higher than the lowest bidder.</p> <p>The work classifications found on the project's wage determination should be mimicked on the certified payroll reports. Workers who split their time between work classifications should be reports as such and paid as such, if applicable.</p> <p>Omitting deductions and net pay for the gross wages earned does not allow the reviewer to determine if kickbacks are occurring. For those employees who receive a 1099-MISC at the end of the year, a memo as to such should be included in the Remarks section of the certified payroll report.</p> <p>Documentation supporting the deduction is required. This could be a court order or a signed memo by the employee, but either way, the City should have documentation supporting the deduction and related approval.</p> <p>For those payrolls signed by other persons, an authorization to sign must be received by the owner/officer.</p> <p>It is possible that what is being reported as a work classification on the certified payroll is not what is actually being performed. Differences in work classifications could result in potential noncompliance with Davis Bacon.</p>
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**Management Response:**

The City is restricted to the Entitlement Area, which includes only Moore residents. The City did request a change to the service area from HUD, on May 13, 2016. This request was denied. Therefore, the City cannot revise the form to include those living outside of Moore.

The Section 3 Plan will be updated to explain the annual changes to area median income values. The City will also make sure that the forms are updated and the updated forms are provided to the contractors.

The Policies and Procedures will be updated to include procurement preferences for Section 3 businesses. All solicitations will also reflect the procurement preference and points will be awarded to those businesses.