

City of Moore

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

October 2016

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 April 1, 2016 through August 31, 2016. 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 July 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 April 1, 2016 through August 31, 2016 (the "testing period")
- Tested all procurement actions conducted during the testing period for adherence to regulatory requirements and applicable policies and procedures
- Reviewed the following documents:
 - Procurement file for Rudy's Construction (focus on Section 3)
 - 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, May 15, 2016
 - 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.

Summary of Results				
Issue Description		Page	Relative Risk	Resolution Level of Difficulty
2016-10-1	Noncompliance with required reporting elements of Section 3 Plan	6	High	Low
2016-10-2	Noncompliance with Section 3 employment goals	7	High	Low
2016-10-3	Noncompliance with Federally mandated contract clauses	8	Moderate	Low
2016-10-4	*Discrepancy between the General Ledger and Project Ledger	8	High	Low
<i>*Indicates items of concern identified in previous audit reports that have not yet been brought to resolution.</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.

Ratings	Conditions
Satisfactory	No significant issues noted. Controls are considered adequate and findings, if any, are not significant to the overall unit.
Needs Improvement	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.
Unsatisfactory	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:

Ratings	Conditions
Program Reporting	Needs Improvement
Program Design	Needs Improvement
Internal Controls – Operating Effectiveness	Needs Improvement

I. Observations and Recommendations

Program Reporting

Observation	Recommendation
1. Noncompliance with required reporting elements of Section 3 Plan	
<p>The following Section 3 reporting weaknesses are noted:</p> <ul style="list-style-type: none"> • The reporting indicated a failure to meet the numerical goal regarding Section 3 employment however, the City does not adequately address its or the contractor's best efforts in the endeavor. • The reporting provided does not appear to reflect other section 3 covered contract information accurately. • Documentation to support employment opportunities appears to support employee salaries paid by contractor as opposed to total household income as required by regulation. 	<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>Management Response:</p> <ul style="list-style-type: none"> • To adequately address the contractor's best effort to meet the numerical goal regarding Section 3 employment, a Section 3 Compliance checklist will be created. The list provides acceptable methods and documentation of new hires. • The Section 3 Plan and applicable procedures were revised to include numerical goals for Section 3 Contracting Opportunities (Professional Services); Two additional forms required are: A form for each employee of a Section 3 business (VDR 05-G) was developed and a procedure for submitting the new form was completed; and a summary form (VDR 05-H) was developed and a procedure for submitting the new form was completed. 	

Program Design

Observation	Recommendation
2. Noncompliance with Section 3 Plan reference to numerical goals	
<p>The current Section 3 Plan does not address the Section 3 numerical goals (3%) related to other Section 3 covered contracts.</p>	<p>We recommend the City incorporate section 3 numerical goals related to other Section 3 covered contracts within its Section 3 Plan.</p> <p>24 CFR Part 135.30(c)(2).</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>Management Response:</p> <ul style="list-style-type: none">• The Section 3 Plan and applicable procedures were revised to include numerical goals for Section 3 Contracting Opportunities (Professional Services).	

Internal Controls – Operating Effectiveness

Observation	Recommendation
3. Noncompliance with Federally mandated contract clauses	
<p>Certain Federally mandated contract clauses were not included in two of the two contracts reviewed.</p> <p>For example, adequate clauses related to 1) the Copeland "Anti- Kickback" Act; 2) the Davis-Bacon Act; 3) Contract Work Hours & Safety Standards Act; and 4) a notice pertaining to patent rights were not present.</p>	<p>We recommend the Federally mandated contract clauses found in 2 CFR Part 200 and 24 CFR Part 85 be implemented into all applicable contracts between the City and all CDBG-DR contractors in order to meet minimum regulatory requirements.</p> <p>The inclusion of required clauses within a standard City terms and conditions document could facilitate the meeting of this requirement.</p>
<p>Management Response: Contracts will be amended to make the federal clauses more clear.</p>	

Observation	Recommendation
4. Discrepancy between the General Ledger and Project Ledger	
<p>The monthly reconciliation of the Project Ledger to the General Ledger does not appear to be completed in an accurate manner. The June 2016 reconciliation did not reconcile.</p>	<p>This discrepancy appears to be due to the untimeliness of the General and Project ledger reconciliation. The issue is exasperated with the City converting to its new accounting software (MUNIS) while payroll is still currently done in the legacy accounting software (INCODE). This results in benefit deductions being hard-keyed by program staff on a monthly basis and given to the external CPA to make journal entry adjustments. Additionally, the June 2016 reconciliation did not take into account fiscal year-end adjustments made to the General Ledger.</p> <p>We recommend that a documented reconciliation process be designed and implemented as soon as possible to address the reconciliation issues noted.</p>
<p>Management Response: Support for journal entries needed to record transactions in the general ledger will be communicated to the accounting department by placing a hard copy in the office of the Assistant</p>	

Finance Director, and by emailing a copy to the contracted CPA completing the journal entries. The sent email shall be printed and placed in the reconciliation file within the Capital Planning & Resiliency department. This will create a dated record of the communication and help to ensure that the communication occurs.

As recommended, the process for reconciliation of the general ledger with the project ledger will be documented and approved by the Finance Director.

II. Enhancement

Observation	Recommendation
1. Noncompliance with Section 3 employment goals	
<p>While the City is currently meeting its numerical goal related to Section 3 business concern contracting, it is not currently meeting its Section 3 employment goal. Regulations provide specific procurement procedures that provide for preference for Section 3 business concerns that could directly affect Section 3 employment and should be considered.</p>	<p>We recommend the City reevaluate its efforts in meeting its Section 3 employment goal to include applicable documentation support needs. The review of examples of effort noted at the 24 CFR Part 135 Appendix and consideration of documentation support would be beneficial.</p>
<p>Management Response:</p> <ul style="list-style-type: none"> • The City already provides a preference for Section 3 businesses (See CDBG/CDBG DR Manual; Section 3). • To adequately address the contractor’s best effort to meet the numerical goal regarding Section 3 employment a Section 3 Compliance checklist is created. The list provides acceptable methods and documentation of new hires. 	