DEPARTMENT OF FINANCE

October 20, 2014

TO: Audit Committee

FROM: Andrew Green
Director of Finance

SUBJECT: Audit Plan Update

As approved at the July 28, 2014 City Council meeting, the City will be filling an Internal Audit Manager position in the City Manager's Office. The Finance Department and the City Manager's Office will continue to work together to maximize the benefits of ongoing internal audit and control functions. The Internal Audit Manager will have the autonomy to audit any area. Finance will provide support and staffing for some of the internal audit activities as well as continuing its monitoring activities.

Pending the arrival of the Internal Audit Manager, staff is providing an update of the internal audits listing presented to the Audit Committee on February 10, 2014. Attachment A is an updated version of the document presented at that time. The following provides additional information on the status of each item in progress and planned for FY 2015.

Audits/Reviews in Progress or Completed (Numbered to Corresponding Number on Attached Spreadsheet):

1. Parking Operations. The Parking Management Policies and Procedures Consulting Services report by Lance, Soll and Lunghard, LLP has been completed and will be presented to the Audit Committee on October 20, 2014. This review was completed as a preliminary step toward a comprehensive review of the City's parking operations. Transportation anticipates presenting the results on two additional engagements related to the administration of City parking operations which will incorporate this review in the next few months

2. Concord Senior Housing. White, Nelson, Diehl, Evans, LLP conducted a forensic review on the Concord Senior Housing Project, owned by the City and located at 275 E. Cordova Street. The review looked at financial and operational developments at the property, which was constructed in the early1970's. Rental revenue from the property serves as a source of the City's funding of the Fire and Police Retirement System, by way of agreements with both HUD and the current landlord, Retirement Housing Foundation (RHF). RHF's ground lease payments to the City for the Concord property are current and was discussed as part of the Housing and Commercial Development Projects Loan Inventory report presented at the August 11, 2014 Finance Committee meeting.

3. Housing and Commercial Development Projects Loan Inventory. Staff has completed its internal review and reconciliation of accounting records and Interlinq Loan software. The findings and recommendations were presented at the August 11, 2014 Finance Committee meeting.

4. Workers Compensation Program. TCS Risk Management Services, LLC, was engaged to conduct an analysis of the W/C program, to identify trends and best practices within Workers' Compensation. This study is complete and revealed that from July 2011 to December 2013 the number of newly filed workers' compensation claims is declining, however, workers' compensation costs are trending higher. This is primarily due to lost time expenses), litigation related expenses (attorney fees and other allocated expenses), and prior claims that have been open for a significant period of time. In an effort to improve effectiveness and reduce costs, a number of operational changes have been implemented as summarized below.

- Increased focus on high exposure claims which have been open for an extended period with little or no action, to bring them to closure.
- Keenan and Associates, the City's third-party administrator, was assigned 120 cases for claim management to allow internal claim management staff to focus more on reducing outstanding long-term open claims and increasing the effectiveness of the City's Return to Work (RTW) program. This increased emphasis on the RTW program is expected to help reduce the percentage of indemnity (lost time) claims versus Medical only and also reduce the overall cost of benefits.
- Examiners are self-managing more claims, rather than referring to defense attorneys when matters of legal concern are not present.
- Monthly statistical reports for each department are being provided to department heads, to ensure that all are informed of claims activity and expenses on a regular basis.

5. Transient Occupancy Tax (TOT) Review. Both phases of this review have been completed by MuniServices. This first year of a multi-year assignment covered the six largest hotels which generate approximately 72% to 75% of TOT revenues. MuniServices written report stated "The City's Administration of the TOT is amongst the best that we have found in California." There were no adverse findings for four of the hotels and the findings on the remaining two were immaterial.

6. Purchasing Contracts and Purchase Order Process and Procedures. McGladrey, LLP completed Phase I and the results were presented to the Audit Committee on May 12, 2014. Phase I was a review of the City's contract and vendor selection process and compliance with City policies. The audit committee expressed a desire for a more in depth review to ensure contract compliance, authorization, and payments were also in compliance with city policies. Phase II will test the compliance with contract terms and verification of approvals under purchase order or contract authorization as well as payments. As was covered at the July 28, 2014 Finance Committee meeting all disbursements for a three year

period over $50,000 will be evaluated for proper authorization. Additionally, the specific steps presented at the July 28th Audit Committee meeting to further increase control and compliance in this area are also being implemented. Phase II testing is underway under the direction of the City Manager's Office.

7. Continued Monitoring of Petty Cash, Cash Handling, and Purchase Card Activity. Staff has been conducting surprise petty cash and cash handling reviews with Departments who handle cash and/or have petty cash accounts. These will be conducted on a perpetual basis to ensure continued compliance. Approximately thirteen surprise counts/reviews have been conducted and more are planned or underway. Over half of the reviews resulted in no findings, three had very minor findings, and three had more significant findings. Revisits were conducted for all of the more significant findings to verify that corrections had been made. Finance intends to complete a minimum of 24 surprise audits per year. Staff has developed a form for reporting the findings to the Department Head, Director of Finance, City Treasurer, and Controller. The form details the finding(s) and the required corrective action(s).

8. Citywide Risk Assessment. Best practices recommend that an Enterprise wide/Citywide Risk Assessment be performed. McGladrey, LLP had also recommended that the City conduct one. As the title suggests, this is more than just an assessment of risk in accounting areas. It is an overall assessment of organizational risks which may have financial or organizational consequences. A risk assessment provides a mechanism for identifying which risks present opportunities and which represent potential pitfalls. This engagement would result in recommended areas for review, a ranking of risk levels, and a means to prioritize audits/reviews. It is anticipated that an Enterprise wide/City Risk Assessment will be conducted after the Internal Audit Manager is hired. This assessment could be performed by the Internal Audit Manager or by an external firm.

9. Accounts Payable Procedures. A review of Accounts Payable Procedures will be a component of the Purchasing Contracts and Purchase Order Process and Procedures Phase II.

10. Pasadena Water and Power (PWP) Inventory. Both City Finance staff and the Brown Armstrong Auditors performed limited procedures in late June 2014. Water and Power use a cycle count methodology where only a portion of inventory is counted with the goal of validating the entire inventory over time. Additional work is required and it is anticipated that this will be completed prior to June 30, 2015.

11. Fleet Operations-Fuel Pump Controls/Repairs and Maintenance. This review has not been started. Staff anticipates utilizing an external resource to conduct this study later in the fiscal year.

12. Capital Asset Acquisition and Disposal. This review has not been started. Staff anticipates utilizing an internal resource to conduct this study later in the fiscal year.

Attachment A reflects the current status of audits and reviews presented at previous Audit Committee meeting as of October 20, 2014.

Attachment B is the final report from Lance, Soll & Lunghards, LLP on parking management.

Attachment:
A) Audit Plan Matrix
B) Parking Management Policies and Procedures Consulting Services

CITY OF PASADENA
AUDIT PLAN -ATTACHMENT A

ITEM	TITLE-DESCRIPTION	RESOURCE	ESTIMATED START	ESTIMATED FINISH	ESTIMATED REPORT	STATUS-COMMENTS AT 10/20/2014
ITEMS 1 TO 12, INTERNAL AUDITS/ACTIVITIES IN PROGRESS OR COMPLETED						
1	**Parking Operations** – Review and make recommendations related to parking garages, administration by three independent contract operators, and control considerations.	Lance, Soll, & Lunghard LLP (LSL)	July 2013	Feb. 2014	Oct. 2014	LSL Report is complete. LSL report to be presented 10/20/2014. Two additional reports pending conclusion and presentation to a Council Committee.
2	**Concord Senior Housing** – Review of agreements, ground lease payments, HUD requirements, deferred maintenance, and beneficial interest granted by City to Pasadena Fire and Police Retirement System.	White, Nelson, Deihl, Evans LLP	August 2013	Dec. 2013	Aug. 2014	Reported to Finance Committee on 8/11/2014.
3	**Housing and Commercial Development Projects Loan Inventory** – Review of outstanding amounts owed to City, inventory and controls over compliance monitoring, billing, and timely follow	Internal	July 2013	Feb. 2014	Aug. 2014	Reported to Finance Committee on 8/11/2014.
4	**Workers Compensation Program** – Current practices are being reviewed against best practices and industry standards.	External	Oct. 2013	Mar. 2014	Oct. 2014	Report is complete and summary will be presented to the Audit Committee on 10/20/2014 as part of the Audit Plan update.
5	**Transient Occupancy Tax (TOT)** – Review by external consultant of six largest hotels in Pasadena in two phases. Phase I auditor offsite requests for information (completed) with Phase II site visits anticipated in the two weeks. This is planned as a multi-year assignment with the largest six hotels generating 72% to 75% of TOT revenue being completed this year. Each year six more hotels will be selected for review. This is to be an ongoing annual process.	MuniServices	Nov. 2013	Mar. 2014	Oct. 2014	Report is complete and summary will be presented to the Audit Committee on 10/20/2014 as part of the Audit Plan update.
6	**Purchasing Contracts and purchase order process and procedures** – Review of City's policies, procedures, and practices related to vendor management, covering vendor selection, contract review and approval, internal controls, due diligence, and security. A sample of vendors/contracts from all departments will be selected. Preliminary planning has been conducted with McGladrey LLP.	McGladrey LLP	1/26/2014	May 2014	Phase I- May 2014, Phase II - pending	Phase I - Completed and presented to the Audit Committee. Phase II - Underway.
7	**Continuing Monitoring of Petty Cash, Cash Handling, and Purchasing Card Activity** – Review by internal staff is continuing on an ongoing basis as a follow up to previous audits. While these are conducted by existing staff with limitations on time available, we believe continued surprise internal audits to be one tool to keep the City in compliance in these three areas. These serve as an adjunct to the ongoing semi-annual trainings related to cash handling and petty cash.	Internal	Ongoing	Ongoing	Dec. 2014	Ongoing

CITY OF PASADENA						
AUDIT PLAN -ATTACHMENT A						
			ESTIMATED			
ITEM	TITLE-DESCRIPTION	RESOURCE	START	FINISH	REPORT	STATUS-COMMENTS
ITEMS 1 TO 12, INTERNAL AUDITS/ACTIVITIES IN PROGRESS OR COMPLETED (CONTINUED)						
8	**Citywide Risk Assessment** – An enterprise wide risk assessment is a management tool to develop the scope and direction of the internal audit program. This report assists the City in allocating resources for maintenance of continuous and sufficient internal audit coverage of areas deemed the highest risk profiles. The City's business objectives will be stated, potential significant risks identified, the control environment assessed, and internal audit strategies established. This is anticipated to take approximately three months from the time of contract award.	Internal Audit Manager or External	3rd Qtr FY 2014	1st Qtr FY 2015	2nd Qtr FY 2015	Not begun.
9	**Accounts Payable Procedures** - Review of Accounts Payable practices and procedures to ensure compliance and measurement against best practices.	Internal Audit Manager or External	4th Qtr FY 2014	2nd Qtr FY 2015	4th Qtr FY 2015	To be included as part of the Purchasing Contracts Phase II review.
10	**PWP Inventory** - The City should as part of it's annual accounting cycle perform some testing of PWP inventory to confirm valuation for inclusion in financial statements.	Internal (Utility Accounting) and External (Brown Armstrong)	2nd Qtr FY 2015	3rd Qtr FY 2015	4th Qtr FY 2015	Limited procedures conducted in 4th Qtr 2014. Additional work required.
11	**Fleet Operations-Fuel Pump Controls/Repairs and Maintenance** - This evaluation will study the access to, accounting for, and use of fuel provided by the City and fleet maintenance operations.	External	1st Qtr FY 2015	2nd Qtr FY 2015	2nd Qtr FY 2015	Not begun.
12	**Capital Asset Acquisition and Disposal** - The process for recording and disposal of assets should be periodically reviewed to ensure that fixed assets are properly recorded.	Internal-Utility Accounting and Controller	1st Qtr FY 2015	2nd Qtr FY 2015	3rd Qtr FY 2015	Not begun.
ITEMS 13 TO 24, INTERNAL AUDITS/ACTIVITES CONTEMPLATED						
FISCAL YEAR 2016						
13	**Independent Contractor Versus Employee Issue** – The IRS has changed their testing method to determine proper classification of employee versus independent contractor and has begun visiting Cities to assure compliance. This review would verify the City's compliance and determine if improved documentation is needed to support the City's position. It would also test that all regulatory items, such as 1099 issuance, are in compliance. It is anticipated that this could be completed in two months once departments have assembled the necessary documentation.	Internal or External	3rd Qtr FY 2015	1st Qtr FY 2016	1st Qtr FY 2016	Not begun.
14	**Leases** – The City is both a lessor and a lessee in a number of properties. This review will utilize an the existing inventory to verify and assure continued and active monitoring of these leases. It is anticipated that this could be completed in three months once departments have assembled the necessary documentation.	Internal or External	4th Qtr FY 2015	2nd Qtr FY 2016	2nd Qtr FY 2016	Not begun.

CITY OF PASADENA						
AUDIT PLAN -ATTACHMENT A						
			ESTIMATED			
ITEM	TITLE-DESCRIPTION	RESOURCE	START	FINISH	REPORT	STATUS-COMMENTS
FISCAL YEAR 2016 (CONTINUED)						
15	**Human Resource Benefits Division/Payroll-Controls Over Benefits -** This review would evaluate the controls and procedures that benefits are properly applied.	Internal or External	1st Qtr FY 2016	2nd Qtr 2016	2nd Qtr FY 2016	This has been moved up to FY15. Human Resources has begun a review.
16	**Accounts Receivable Collection Procedures -** Similar to the recent efforts related to loans made by the City, all receivables and their related procedures would be reviewed to insure that the City is collecting all amounts due.	Internal or External	3rd Qtr FY 2015	1st Qtr FY 2016	1st Qtr 2016	This will be moved up with the hiring of the Fiscal Services Administrator. Not begun.
17	**PWP Power Trading -** The trading transaction which the City enters into are high dollar and complex.	External	3rd Qtr FY 2015	2nd Qtr FY 2016	3rd Qtr FY 2016	Utility expertise will be required to perform this study. Not begun.
18	**Budget/Human Resources Position Controls -** This study would evaluate the budgetary control over the addition and reduction of City employees.	Internal or External	3rd Qtr FY 2015	1st Qtr FY 2016	1st Qtr FY 2016	Not begun.
FISCAL YEAR 2017						
19	**Purchasing Card Follow-up -** Last year the City completed an extensive audit of purchasing card usage to verify compliance with City policies and procedures. This would provide for periodic spot checks to verify ongoing compliance.	Internal	3rd Qtr FY 2016	4th Qtr FY 2016	1st Qtr FY 2017	Not begun.
20	**Citywide Refund Process -** The City issues refunds initiated by a number of City departments. This review would examine the various processes to insure compliance with City policies and best practices.	Internal or External	4th Qtr FY 2016	2nd Qtr FY 2017	3rd Qtr FY 2017	Not begun.
21	**Take Home Vehicles -** Last reviewed by internal audit in 2008, this would update that study for Citywide compliance with IRS requirements.	Internal	1st Qtr FY 2017	2nd Qtr FY 2017	2nd Qtr FY 2017	This would include evaluation of garage location, safety, and other IRS exemptions. Not begun.
22	**ARTS-Fare Box Controls -** Similar to the study on cash handling, this study will review the controls over the fares collected.	Internal or External	1st Qtr FY 2017	2nd Qtr FY 2017	2nd Qtr FY 2017	Not begun.
23	**Library Controls -** The cash handling study indicated the need for further review, especially for the Library where the dollar amounts are very small and there are staffing limitations on segregation of duties.	Internal	1st Qtr FY 2017	2nd Qtr FY 2017	2nd Qtr FY 2017	Not begun.
24	**PWP Billing -** This is a specialized billing system which should be evaluated for best practices and internal controls.	Internal or External	1st Qtr FY 2017	2nd Qtr FY 2017	3rd Qtr FY 2017	Not begun.