

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

***MEMORANDUM***

To: Ron Carlee, City Manager  
From: Greg McDowell, City Auditor  
Re: Fiscal Year 2013 Audit Summary

July 22, 2013

The Internal Audit Division completed ten performance audits during fiscal year 2013, as follows:

- ARRA: Stimulus Reporting in FY12 (October 2012)
- Solid Waste Services City-Wide at 6/30/12 (October 2012)
- CATS: Bus Imprest (October 2012); Blue Line Extension – STV/RWA Direct Labor, Overhead and Fees; January 2008 through December 2011 (October 2012)
- Accounting and Procurement Controls – Purchased Assets (January 2013); Investments (April 2013); Vendor Authenticity (April 2013); Accounts Payable Payment Policy (June 2013)
- Payroll (March 2013)
- Police Vice Imprest (May 2013)

At fiscal year-end, significant audits in progress include Business Tax Audit Follow-Up; Citywide Overtime; Authorized Contracts and Payments; CATS Blue Line Extension STV/RWA; and an Energy Stimulus Grant (EECBG). These are detailed at the end of this report.

**AMERICAN RECOVERY AND REINVESTMENT ACT**

*Stimulus Audit Work for FY12* – During fiscal year 2012, the City finalized grant projects totaling \$6.0 million with Federal (Direct) award amounts and \$3.9 million in sub-recipient (Indirect) grants. Previously received grants still in process total \$106.4 million Direct, and \$8.5 million Indirect.

Although minor adjustments were required, effective controls continue to help ensure accurate reporting of total expenses. The audit found errors in several grants that will be corrected in the next quarter. Corrections continue to be made quarterly to the FTEs (full-time equivalent jobs created) reported. In addition, Internal Audit noted non-compliance with Davis-Bacon regulations and has recommended that Project Managers (PMs) confirm to the Economic Stimulus Team (EST) coordinator in the future that all payroll documents have been received and payrolls are certified. Although outside our scope of procedures, we noted five instances of non-compliance with Buy American (the Buy American provision of ARRA requires that

infrastructure projects use iron, steel and manufactured goods produced in the United States). We have recommended that the EST coordinator obtain assurance that Buy American is checked quarterly.

As grants near completion, PMs need to ensure that the FTEs reported on the §1512 report are calculated accurately and prior corrections have been included. PMs also need to confirm that ARRA expenditures and receipts in GEAC agree to the amounts on the §1512 report.

*Update:* The EST coordinator accepted the Audit recommendations and implemented the necessary steps to improve controls. Quarterly audit reviews will review compliance with the improved process.

## **MANAGED COMPETITION**

*SWS City-Wide Services 6/30/12* – For the six months and year-ended June 30, 2012, Internal Audit found that SWS has accurately compiled its costs of operations for city-wide services. After recommended audit adjustments of \$17,000 increasing savings, operations were under budget \$450,037 for the six months ended June 30, 2012. These savings represent more than 4% of the approximately \$10.7 million in revenue. Fiscal year-to-date (full year) operations were under budget by \$593,196, or about 3% of revenues totaling nearly \$21.2 million.

During the six months and year-ended, approximately 210,087 households were served, and a total of 230,596 tons of solid waste was removed. The adjusted cost of service per household for the six months and year-to-date was \$8.18 and \$8.20, respectively, as compared to the budget projected service cost of \$8.35. The cost per ton removed was \$92.42 for the six months and \$89.50 year-to-date.

The SWS residential model has transitioned from managed competition and optimization in FY10 to city-wide service in FY11. Prior to FY11, the North, South and East Districts of the City were serviced by SWS staff and the West District was contracted out. Since July 2010, refuse, yard waste and bulky collection services have been performed by SWS City-wide, while recycling is being performed by an outside contractor.

Internal Audit completes an annual review of Solid Waste Services' budget and financial results. A report is submitted to the PCAC to address whether SWS's budget and operations have been completed in accordance with its plan developed during the transition noted above.

## **CATS-RELATED**

*Bus Operations Division (BOD) Imprest FY12* – The purpose of this audit was to determine whether the City has reimbursed the bus operations management company, Transit Management Company (TMC), accurately and the funds have been disbursed properly. The City's outside auditor, Cherry Bekaert LLP, performs agreed-upon procedures related to the Bus Operations Division (BOD) that cover the inventory of buses, bus parts and payroll. The work performed by Internal Audit is provided to Cherry Bekaert auditors for their review.

Overall, the system of controls used by TMC is satisfactory. The wire transfers are accurately recorded, and reimbursement requests are adequately supported. TMC has been responsive to audit recommendations made in prior years. Some minor errors were brought to management's attention during the current audit. Individually, the errors are not material. However, the repetitive nature of the findings suggests that TMC needs to improve its attention to detail. TMC should give closer attention to monitoring wire transfers so negative balances are avoided, and to documentation that supports employee withholdings.

In response to our 2011 report, TMC developed procedures to monitor the bank balance and assure the obligated funds were available in the imprest account at the appropriate time. Even though the procedures have been established, the account was overdrawn three different days during FY12. The negative balances occurred due to accounting errors which were later corrected. TMC should closely monitor the balance in the imprest account to assure that a negative balance does not occur, or is corrected quickly.

TMC agreed with the recommendations and has developed satisfactory plans to address each issue.

CATS: Blue Line Extension – STV/RWA Direct Labor, Overhead and Fees (January 2008 through December 2011) – We have completed an audit of STV/RWA's Direct Labor, Overhead and Fees for its Northeast Corridor Light Rail Transit Project (BLE), covering January 2008 through December 2011. For the period audited, STV/RWA submitted 48 project-related invoices to CATS totaling \$31,404,392. Auditors reviewed direct labor charges of \$7,838,487 and overhead and fees of \$13,037,352. The audit did not include a review of other direct costs which totaled \$10,528,553.

Auditors addressed STV/RWA and resolved a number of issues related to the company's direct labor charges. During the audit, STV/RWA supplied timely responses and documentation. As a result, there are no findings related to direct labor for the audit period. As is typical in contracts involving federal funding, the contractor used a provisional overhead billing rate, which is adjusted to the actual rate following completion of a financial audit. Our review of overhead rates found that a reconciliation payment totaling \$21,622 was due from STV/RWA, to reflect audited results from 2008 through 2011. Prior to this audit, CATS agreed to begin conducting annual overhead reviews for prime contractors in FY13, and further, will hold the prime responsible for conducting similar overhead reviews of its subcontractors. Internal Audit concurs with this approach.

Other than the need to reconcile overhead rates, there were no audit findings. These results indicate a high level of compliance with Federal contracting guidelines by the contractor, along with effective administrative efforts by CATS staff.

STV/RWA had previously agreed with the reconciliation provided by Internal Audit. Following CATS' formal request for reimbursement, STV/RWA made a reconciling payment to the City for \$21,622.

## ACCOUNTING AND PROCUREMENT CONTROLS

Purchased Capital Assets FY2012 – We have completed an audit designed to verify the existence of capital assets purchased between July 1, 2011 and June 30, 2012. We also verified that the assets were reasonably safeguarded. As part of this audit, we reviewed the City's capital asset procedures, including inventory and asset tagging processes. Of the 557 capital assets purchased during FY12, we selected 75 assets (13%) for review. The sample consisted of 32 rolling stock and 43 non-rolling stock assets.

All 75 assets tested were accounted for, and all but one was adequately safeguarded. (One item had been stolen and reported to Police.) One asset was misclassified, leading to the discovery that similar items meeting the City's capitalization threshold had not been recorded. Also, the City does not have an approved capital asset policy. Finance has planned to initiate an appropriate policy regarding citywide capital assets, which will address this asset category. Policy development will coincide with the implementation of the City's ERP system.

Based on our testing, we are satisfied that procedures are functioning adequately to ensure that capital assets purchased in FY12 are present and properly secured.

Investments – This audit addressed two funds, the Consolidated Investment Fund (CIF) and the Long Term Investment Program (LTIP). We concluded that the City's Finance Department has managed investments satisfactorily, based upon the following:

- Investments and trading activities comply with North Carolina state statutes.
- City Finance personnel followed established policies and procedures.
- Internal controls are adequate to maintain appropriate segregation of duties, and to ensure continued compliance with state statutes and City policies.

Vendor Authenticity – This audit assessed how the City determines that vendors are authentic – in advance of, and separate from the payment authorization process.

Although no inauthentic or fictitious vendors were identified, the limited sample size prevents a conclusion regarding the entire vendor database. The potential negative consequences related to vendor fraud and payment errors are so great that controls should be improved to further reduce those risks. Current payment controls for vendors under \$2,500 result in only limited assurance that all vendors are authentic. A formal review process would help ensure that vendors meet a predetermined and consistent set of standards prior to their addition to the active vendor database. Data quality needs improvement, or risks to the vendor payment process will increase. Although MUNIS, the new Enterprise Resource Planning (ERP) system, will begin with verified vendor information and updated policies, specific issues must be addressed to maintain the database's quality over the long term. Maintaining database integrity can help prevent fraud and errors.

Management from Finance, Shared Services and the OCIO agreed with our recommendations, which will require the development of new policies during the ERP implementation.

Accounts Payable Payment Policy (FIN6) – The audit was designed to determine the reasons for non-compliance with certain sections of the Accounts Payable Payment Policy (FIN6) and to recommend solutions for consideration, if appropriate. For the period July 1, 2011, through March 31, 2013, Internal Audit obtained the quarterly reports prepared by the Finance Department which list direct payments of \$10,000 or more. Auditors inquired with Departments about their responses to Finance to determine the reason the payment was made via direct pay, what prevented the department from complying with FIN6 and the impact on compliance with other City procurement policies.

We concluded that the current reporting mechanism provides adequate information to allow Finance, Department Managers and the City Manager's Office to monitor compliance with the Accounts Payable Payment Policy. While department managers are aware of exceptions and are taking action to decrease non-compliance, departments agree that the number of payments which are not compliant with the Policy can be further reduced.

*Note:* Internal Audit will conduct follow up reviews of FIN6 reports issued to departments for the quarter ending June 30, 2013.

## **PAYROLL**

Payroll (January 2011 – June 2012) – The purpose of this review was to test the internal controls, evaluate the accuracy of employee information in PeopleSoft and to verify compliance with government regulations. The audit did not address timekeeping or overtime. We tested payroll transactions that were processed from January 1, 2011, through June 30, 2012.

City payroll processes are operating in a strong control environment. While the majority of our audit tests found a high level of compliance, document controls require improvement. During the audit, some documents required to support hiring actions, along with some pay change approvals, could not be located in the electronic files. Human Resources staff agreed with our findings and, during the audit, completed a control checklist to be used for all new hires. (This control document had been under development prior to the audit.) Finally, we recommend that the City discontinue the requirement for hard copy approvals to weekly payrolls which are submitted by each department. The electronic controls have been tested and found to be satisfactory.

*Note:* A separate review of timekeeping and overtime is in progress.

## **POLICE**

Vice Imprest 2012 – It has been the CMPD's practice for many years to request an audit of its Vice Imprest Fund prior to obtaining replenishment. During calendar year 2012, Internal Audit conducted four such reviews. The overall accounting controls in place related to the Vice Imprest Fund are adequate and operating satisfactorily. The accounting for the Imprest fund and the related case documentation are detailed and complete. While controls over Vice Fund operations have been adequate, CMPD has continued to increase its tracking of cash advances. Internal Audit supports those actions.

## **CATS CONSTRUCTION FOLLOW-UP**

From 2006 through 2011, we conducted several audits of PTG and its subcontractors. Some audits noted that CATS had disallowed certain expenses during the initial review of invoices. Internal Audit reviewed and supported those disallowances, but also encouraged CATS staff to conduct more rigorous reviews. Most of the audits questioned a small percentage of charges and recommended various recoveries. Occasionally, recommended recoveries were substantial. In some instances, contractors resolved the questioned costs by submitting appropriate documentation which had not been provided during the audits.

CATS has collected on the following recommended disallowances: \$83,011 from PTG and STV (Other Direct Costs through 2004); and \$174,145 from PBS&J (Labor, Overhead and Fees, 2003-2006). CATS Legal is in discussions with PTG to resolve a number of contractual claims, including issues raised in past audits. In 2012, Internal Audit provided schedules and documentation to support our previous findings related to PTG and certain subcontractors. At year-end 2012, PTG was continuing to review those documents. (No change in status was reported by CATS in fiscal year 2013.)

In April 2010 and December 2011, Internal Audit recommended disallowing \$93,067 and \$72,000, respectively, related to STV Other Direct Costs from FY07 through FY09. Following discussions between CATS and STV, CATS requested that Internal Audit re-evaluate STV's documentation and responses. Audit conducted that review in September 2012 and reduced the total recommended disallowance from \$165,067 to \$123,482. CATS subsequently initiated discussions with STV with the intent to pursue the revised amount; however, a resolution has not been reached. CATS noted that internal controls have been strengthened, and corrective actions have been taken, which will likely reduce future audit findings. Internal Audit supports the actions taken.

In June 2012, Internal Audit reported that the reconciliation of STV's overhead rates through September 2011 resulted in a reconciling payment due of \$240,538. This amount was received in a timely manner. (An audit of STV's overhead rates through September 2012 is in progress.)

## **FOLLOW-UP – OTHER**

Unit Pricing of CMPD Uniforms (January 2012) – Internal Audit completed a detailed analysis of items purchased by CMPD for the final two years (August 2008 – August 2010) of its 2004 contract. Purchases for that period totaled about \$1.8 million. The audit concluded that CMPD overpaid Best Uniforms by about \$64,600. The overpayments were due to specific overcharges on contract items, excessive charges related to non-contract items and unauthorized charges related to oversized items. While some overcharges were clear, some were subject to dispute. During the period of the audit, CMPD did not adequately monitor the contract. However, a subsequent contract includes improved processes to address any price changes, and CMPD staff has put in place improved monitoring procedures.

*Update:* Internal Audit recommended that the City negotiate a reasonable settlement of estimated overpayments rather than incur additional costs to audit the earlier years of the contract. The City Attorney's Office and CMPD negotiated a \$40,000 credit from Best Uniforms, which was applied to four subsequent monthly invoices in equal installments.

Business Taxes (February 2012) – Last year, we completed a review of the City's business tax revenues. These revenues are collected by and received from Mecklenburg County's Business Tax Collections (BTC) Office of the Mecklenburg County Office of the Tax Collector (OTC). Business taxes include Business Privilege License Tax; Heavy Equipment Rental Tax; Occupancy Tax; Prepared Food & Beverage Tax; and Vehicle Rental Tax. This audit focused primarily upon the Business Privilege License and Prepared Food & Beverage taxes. The scope of our audit was significantly limited by auditors' inability to access records maintained by the County. While our findings are adequately supported, additional findings and conclusions may have been determined if the County had allowed us to review tax data directly throughout the entire audit.

**Conclusion:** While the County collects significant business tax revenues for the City (approximately \$72 million in FY11), additional revenues may go uncollected due to non-compliance by companies that are required to self-report their taxable income.

**Summary Results:** Voluntary compliance with Business Tax requirements, along with the County's efforts to discover and collect unpaid taxes, result in the majority of business taxes being collected in a timely manner. However, audit tests indicated that additional revenues in the range of 5-15% may go uncollected in some categories of Business Taxes.

We compared Prepared Food & Beverage Tax records to Health Department records and referred a number of potential non-paying businesses to the County Tax Collector. Similarly, we compared the Business Privilege License Tax (BPLT) records to the City's database of vendors and referred potential non-compliant businesses to the County Tax Collector. (Research must be conducted to determine that such businesses are currently operating, and whether payment may have been made under another business name.)

A specific review of 175 ARRA recipients identified 34 vendors who were not current on the BPLT requirement during the audit. At the conclusion of the audit, 24 (14%) remained uncollected.

Auditors identified a monthly vehicle rental tax payment that was several months late in being remitted by the County. The payment was promptly resolved when brought to the County's attention. City Finance has implemented additional monitoring steps to identify any lateness in the future. Finally, we recommended that City Finance discuss with the County a more effective approach to auditing the business taxes on the City's behalf.

*Update:* Finance responded to the City Manager, noting their agreement with the recommendations. Finance re-drafted the City purchase order language, with input from Legal, informing prospective vendors of the requirement to obtain a business license.

Discussions with the County are pending. In June 2013, Internal Audit initiated a follow-up to address the status of specific vendors identified in the 2012 audit.

### **AUDITS IN PROGRESS @ June 30, 2013**

- Blue Line Extension-STV/RWA Direct Labor, Overhead and Fees (January 1, 2012 through September 30, 2012) – We have reviewed preliminary audit results with CATS and forwarded a draft report to STV for review. A final report will be issued in July.
- City-wide Overtime (July 1, 2009 through June 30, 2013) – We have met with most departments to discuss overtime policies and procedures for each division. We have begun testing and will work with divisions as we perform the audit work. Test work will be ongoing for the next few months.
- Quarterly Stimulus – Our quarterly review for the period ended June 30, 2013, will begin in July. The 2013 annual report will be completed following this review. As many grants have been completed or are very close to being final, we are requesting the Project Managers for these grants verify that the final reporting numbers agree with GEAC.
- Energy Efficiency and Conservation Block Grants (EECBG) Stimulus Audit – We began an audit of the Energy grant received by the City as part of the ARRA program. We have coordinated our efforts with the outside auditors who also review this grant in their annual review.
- Business Tax Audit Follow-Up – We are planning to follow up on the findings and recommendations included in our February 2012 report “Business Taxes Received Via County.” We will review the status of recommendations as well as examine new samples. An announcement and request for review of our samples has been sent to the County. This effort will be coordinated with City Finance and is expected to extend over several months.
- Authorized Contracts and Payments – In early June, we notified all departments that we planned to audit the City’s disbursements to the entities paid the most in FY13, whether related to a new or existing contract, a Council-approved disbursement or any other process. For this audit, we will examine supporting documentation related to contracts and/or Council approvals, and determine that payments to these vendors are valid and that a proper procurement process was followed, when appropriate. Auditors will begin with the entities (vendors/contractors/municipalities) that have been paid the most, regardless of purpose; therefore, some Departments and Divisions will not be included in the first phase of reviews. Fieldwork commenced in mid-June and is expected to continue for a few months.