

Memorandum



CITY OF DALLAS
(Report No. A09-018)

DATE: September 18, 2009

TO: Honorable Mayor and Members of the City Council

SUBJECT: Review of Internal Controls Over Certain Financial Processes at the Department of Aviation

The Department of Aviation's (AVI) system of internal controls appears to be designed appropriately and functioning as intended for the following financial processes selected for documentation and review: 1) Cash Receipts / Accounts Receivable / Revenue; 2) Accounts Payable / Purchasing; 3) Payroll; 4) Inventory; 5) Fixed Assets; 6) Debt; 7) Contract Monitoring; and, 8) Budgeting. No material weaknesses were noted; however, there are opportunities for improvement in the following processes: Cash Receipts / Accounts Receivable / Revenue, Payroll, Fixed Assets, and Inventory. (See Attachment I for a detailed discussion).

The City Auditor's Office, in conjunction with AVI personnel, selected the processes noted above based on a risk assessment. The risk assessment considered both the materiality of the financial process and the susceptibility of the underlying account balances, transactions, or other supporting information to a material misstatement in the financial statements in determining which processes to review. (Note: AVI accounts for approximately seven percent of the City's total Enterprise Fund revenues and approximately two percent of the City's total overall revenue budgeted for Fiscal Year 2008-2009).

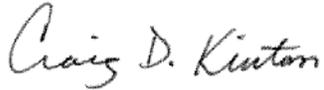
Documentation for each selected financial process was developed with, and validated by, AVI personnel. The review results and opportunities for improvement were discussed with AVI personnel. AVI personnel agreed with the results and the opportunities for improvement as noted in AVI's response. (See Attachment IV for responses). In addition, AVI personnel have agreed to maintain the documentation and monitor internal controls over the selected financial processes.

The City has hired an independent Certified Public Accounting (CPA) firm to perform a similar review and documentation project, on a City-wide basis, of the internal controls over the Cash Receipts / Accounts Receivable / Revenue process.

Management agreed with all eight of the recommendations contained in the report.

If you have any questions or need additional information, please contact me at 214-670-3222 or Carol A. Smith, Assistant City Auditor, at 214-670-4517.

Sincerely,

A handwritten signature in cursive script that reads "Craig D. Kinton".

Craig D. Kinton
City Auditor

Attachments

- C: Mary K. Suhm, City Manager
- Dave K. Cook, Chief Financial Officer
- A.C. Gonzalez, Assistant City Manager
- Daniel T. Weber, Director of Aviation
- Terry Mitchell, Assistant Director of Aviation
- Kenneth Gwyn, Assistant Director of Aviation
- Teralandur Kasturi, Accounting Manager – Department of Aviation
- Jon Hooper, Budget and Finance Manager – Department of Aviation

Attachment I

The Department of Aviation’s (AVI) system of internal controls appears to be designed appropriately and functioning as intended for the following financial processes selected for documentation and review: 1) Cash Receipts / Accounts Receivable / Revenue; 2) Accounts Payable / Purchasing; 3) Payroll; 4) Inventory; 5) Fixed Assets; 6) Debt; 7) Contract Monitoring; and, 8) Budgeting. No material weaknesses were noted; however, there are opportunities for improvement as discussed in Table I below.

Management’s complete responses to the opportunities for improvement and other report recommendations are included in Attachment IV.

Table I

Process	Opportunities for Improvement
<p>Cash Receipts / Accounts Receivable / Revenue</p>	<p>Record Bad Debt Expense Related to the Use of North Texas Toll Tags for Airport Garage Parking</p> <p>The Department’s Toll Tag Coordinator is tracking the uncollected amount (bad debt) related to Toll Tag fees for the parking garage. However, the related bad debt expense has not been recognized in the City’s financial system. From January 2007 through December 2008, there has been approximately \$50,000 of Toll Tag fees considered non-collectible which have not been recorded in the City’s financial system. This is less than one percent of the actual revenues for the same period. Note: Parking garage revenue for FY 2007 through FY 2008 was \$26,263,530.</p> <p>According to the Toll Tag Coordinator, payment is considered uncollectable if the payment is not received within 120 days from the date of the payment request letter.</p> <p>AVI should review and comply with Administrative Directive 4-10, <i>Delinquent and Uncollectable Accounts Receivable</i>, and formally document Toll Tag processing procedures. These procedures should address Toll Tag non-payments and the recognition of bad debt expense related to Toll Tag processing in the City’s financial system. The Toll Tag Coordinator and accounting personnel should establish the receivables, the allowance for uncollectible amount and the write-off amount for the bad debt for FY 2009 and subsequent fiscal years.</p>

Process	Opportunities for Improvement
Cash Receipts / Accounts Receivable / Revenue	<p>Deposit Cash Receipts in Accordance with the City's Administrative Directive</p> <p>Cash receipts from 25 days were tested. Six cash receipts were not deposited within 24 hours, or one business day, of receipt as required in the City's Administrative Directive 4-13, <i>Cash and Debt Management Policies and Procedures</i>.</p> <p>AVI should deposit all cash receipts within one business day according to Administrative Directive 4-13.</p>
Cash Receipts / Accounts Receivable / Revenue	<p>Initial Overnight Deposit Storage Log</p> <p>A review of the overnight deposit storage log indicated that it was not initialed by two employees for three of the 25 days tested. According to AVI procedures, two employees are to take the overnight deposit to the safe and both employees are to initial the log each evening.</p> <p>AVI should ensure that the overnight storage of cash receipts is performed by two employees who individually initial the deposit storage log.</p>
Payroll	<p>Do Not Delegate Payroll Approval by Sharing Username and Password Access</p> <p>Two Supervisors delegated time approval responsibilities in the HRIS system by providing their usernames and passwords to two employees. With this access, the two employees approved their own time.</p> <p>AVI should ensure supervisors do not share HRIS system usernames and passwords with employees for payroll approval.</p>
Fixed Assets	<p>Perform and Document the Annual Fixed Assets Physical Inventory</p> <p>One hundred percent of fixed assets are normally inventoried during the annual physical inventory. For FY 2008, the annual fixed assets physical inventory was only partially completed. However, all fixed assets were reconciled to the fixed asset registry and the general ledger for FY 2008.</p> <p>AVI should ensure 100 percent of the fixed assets are included in the annual physical inventory.</p>

Process	Opportunities for Improvement
<p>Fixed Assets</p>	<p>Perform Fixed Assets Reconciliation Controls Quarterly or Semi-Annually</p> <p>The internal controls related to the reconciliation of the fixed assets to the City’s financial system is currently performed on an annual basis. This leaves a sizable amount of work to be performed in a short amount of time at the end of the fiscal year.</p> <p>AVI Accounting personnel should consider performing the fixed assets reconciliations quarterly or semi-annually to reduce the amount of time required at year-end.</p>
<p>Inventory</p>	<p>Document Storeroom Inventory Issue Log Completely</p> <p>As inventory is issued to AVI personnel, a log is used to document the description of the inventory item(s), quantity, request date, and requestor signature. Testing indicated missing descriptions and / or requestor signatures on the inventory log for six of the 25 days tested.</p> <p>AVI should ensure that all storeroom inventory issues are logged and the log is signed by receiving personnel.</p>
<p>Inventory</p>	<p>Approve Storeroom Inventory Purchase Request Forms</p> <p>Two purchase request forms related to storeroom over-the – counter purchases from the 15 weeks tested did not have both the Division Manager and the Assistant Director signature approval prior to placement of the order. Additionally, three purchase requests tested were not dated; therefore, we could not determine if the orders were placed prior to the Division Manager and the Assistant Director approval.</p> <p>AVI should ensure that all storeroom inventory purchase request forms are approved (signed and dated) by both the Division Manager and the Assistant Director prior to the order being placed.</p>

In addition, to the opportunities for improvement noted above, the City Auditor’s Office recommends that AVI retain, monitor, and update the internal control documentation (narrative, segregation of duties, and control matrix) so that AVI can rely on the documentation as the basis for the annual internal control certification to the City Manager and the City Auditor. The following are some suggested guidelines:

Responsibility Assignment

In order to ensure that the internal control documentation is adequately stored and reflective of current financial processes, AVI should assign the responsibility for maintenance and updating of the internal control documentation to one employee. The employee assigned would be responsible for ensuring that the electronic documentation is current and stored on a secured network drive with restricted access.

Control Documentation

The internal control documentation must be maintained on a secured network directory so that only the designated employee has access to the electronic documentation. Access to the internal control documentation folder should be limited to the designated employee and one or two other employees who would act as a backup. *Note: To ensure version control, the documentation should be maintained in only one network directory.*

Updates to Documentation

The designated employee who has responsibility for the maintenance and storage of the electronic documentation should schedule the documentation updates for the upcoming fiscal year. The designated employee should notify the applicable personnel responsible for the process documentation (process owner) each time the documentation is scheduled for review. The frequency of this review is up to the designated employee, but could be performed quarterly or, at the very least, semi-annually to ensure the internal controls for each process documented are valid and reflect the current business processes.

The notification to the process owners with the applicable documentation and request to review, update, and return would include, but not be limited to the following:

- Upon receipt of the process owner comments, the designated employee should ensure the version number for the process documentation is updated, make the applicable changes, and save the revised documentation to the secured directory.
- A statement that upon request for review, process owners should provide the following response:
 - No changes have occurred since the last review , or
 - Changes to the documentation have occurred since the last review as noted

Testing Controls

The designated employee should also be responsible for regular testing of the internal controls for each process and documentation of the results. The designated employee should test internal controls, on a sample basis, from each process at least twice a year to ensure the controls are operating effectively.

Annual Certification

At the end of the fiscal year, the designated employee should distribute a certification to all process owners. The certification could be an e-mail with the statement that the internal controls for the process are reflective of current processes and are operating effectively. The responses received should be saved in the same secured directory as the process documentation for the corresponding fiscal year.

Attachment II

Background, Objectives, Scope and Methodology

Background

The City of Dallas Administrative Directive (AD) 4-9, *Internal Control*, requires Department Directors to submit an annual certification to the City Manager and the City Auditor that:

- Departments have established and documented the system of internal control procedures
- The system of internal controls has been evaluated
- Submit a signed certification annually to the City Manager and the City Auditor regarding evaluation of the internal control system

Although AD 4-9 provides for an annual internal control self-assessment and encourages departments to prepare flowcharts and narratives to document internal controls, it does not specify a methodology to prepare this documentation. In addition, AD 4-9 was not designed to focus on the internal controls over financial reporting.

In July 2007, the City Auditor's Office discussed the benefits of implementing a Sarbanes-Oxley Act (SOX) type approach to document and evaluate internal controls with the Office of Financial Services (OFS). These benefits include an opportunity to renew the City's focus on governance and ethics, reinforce the tone from the top, strengthen internal controls, streamline processes, and improve transparency and disclosure. In addition, the structure of the SOX internal control documentation requirements provides a methodology to assess the design and effectiveness of internal controls.

The Sarbanes-Oxley Act

The Act passed in 2002 requires all publicly traded companies to issue an annual internal control report that contains management's assertions regarding the effectiveness of the company's internal control structure over financial reporting.

Source: Sarbanes-Oxley Act of 2002

OFS agreed that undertaking this type of project would benefit the City and proposed hiring a consultant for an internal control documentation and review engagement. In an effort to reduce the engagement costs, the City Auditor and OFS worked together to prepare a City-wide financial statement risk assessment. This risk assessment helped ensure that the consultant's documentation and evaluation is focused on the most significant internal control processes.

Recognizing that cost constraints would prohibit the City from including all departments in the project, the City Auditor's Office included an internal control documentation and review for the Department of Aviation (AVI) in the Fiscal Year (FY) 2008 Audit Plan.

The SOX methodology and assessment guidelines were used to prepare the process documentation for the Department. This documentation includes the following:

- Process narrative
- Segregation of duties matrix
- Control matrix
- Testing plan
- Testing results

If properly maintained and updated by Department personnel, the documentation will provide the underlying support for the annual certification of internal controls to the City Manager and the City Auditor.

Objectives and Scope

The objectives of the project were to:

- Document internal controls over certain financial processes identified through the risk assessment
- Review each process for proper segregation of duties
- Test the internal controls identified for each process
- Assess the design and determine whether the internal controls for each process were operating as intended

The project scope covered selected financial processes during the period October 1, 2008 through May 31, 2009. This audit was conducted under the authority of the City Charter, Chapter IX, Section 3 and in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Methodology

The City Auditor's Office conducted a risk assessment on the AVI's FY 2007 financial statements with assistance from AVI. The financial statement risk assessment involved evaluating each financial statement line item against the

following factors which were judgmentally assigned weights ranging from ten percent to 45 percent:

- Materiality (dollar value)
- Susceptibility of loss due to errors or fraud
- Volume of activity and complexity
- Nature of account (automation or manual; use of estimates)
- Accounting and reporting complexities related to the account(s)
- Changes from prior year and prior year audit deficiencies relevant to financial statements

Each financial statement line item was assessed against the six evaluation factors above and assigned a numerical risk ranking of “1” (low), “2” (moderate) or “3” (high). The numerical rank of each evaluation factor for the financial statement line item was calculated to arrive at the total weighted risk rank. Those financial statement line items with a total weighted risk rank of “3” were considered significant to the financial statements. Based on the financial statement risk assessment, input from the Accounting Manager, and auditor judgment, the following processes were deemed to have a significant impact on the financial statements and were selected for documentation:

- Cash Receipts / Accounts Receivable / Revenue
- Accounts Payable/Purchasing
- Payroll
- Inventory
- Fixed Assets
- Debt
- Contract Monitoring
- Budgeting

These processes were documented in a narrative format and the internal controls for each process were identified. The process narratives and internal controls were documented based on interviews, observation, and / or a walkthrough of the process, including validation by AVI personnel.

The testing period was October 1, 2008 through May 31, 2009. Testing sample sizes were based on frequency of control occurrence according to accepted private sector criteria as noted below:

Control Frequency	Sample Size
Daily	25
Weekly	15
Monthly	3
Annually	1

Attachment III

Major Contributors to This Report

Carol A. Smith, CPA, CIA, CFE, CFF, Assistant City Auditor
Kevin Hannigan, CIA, Project Manager
Kimeca Jackson, Auditor
Theresa Hampden, CPA, Quality Control Manager

Attachment IV

Management's Response

Memorandum



DATE: 9/9/2009

TO: Craig D. Kinton, City Auditor

SUBJECT: Response to Review of Internal Controls Over Certain Financial Processes at the Department of Aviation

The Department of Aviation is very pleased to have the opportunity to respond to the recently completed review of internal controls of certain financial processes. I note that the overall controls were "designed appropriately and functioning as intended." The documentation of those processes, which were a product of the review, will be extremely valuable as we strive to strengthen our internal controls systems.

Our responses to the opportunities for improvement cited in the review of internal controls of certain financial processes are as follows:

Recommendation 1:

Record Bad Debt Expense Related to the Use of North Texas Toll Tags for Airport Garage Parking

The Department's Toll Tag Coordinator is tracking the uncollected amount (bad debt) related to Toll Tag fees for the parking garage. However, the related bad debt expense has not been recognized in the City's financial system. Over the previous two fiscal years (FY) (2007 and 2008) there has been approximately \$50,000 of Toll Tag fees considered non-collectible which have not been recorded in the City's financial system. This is less than one percent of the actual revenues (\$23,398,599) for the same period.

According to the Toll Tag Coordinator, payment is considered uncollectable if the payment is not received within 120 days from the date of the payment request letter.

AVI should review and comply with Administrative Directive 4-10, *Delinquent and Uncollectable Accounts Receivable*, and formally document Toll Tag processing procedures. These procedures should include non-payment and recognition of Toll Tag related to bad debt expense in the City's financial system. The Toll Tag Coordinator and accounting personnel should establish the receivables, the allowance for uncollectible amount and the write-off amount for the bad debt for FY 2009 and subsequent fiscal years.

Management Response / Corrective Action Plan

Agree Disagree Partially Agree

Concur. The Aviation Toll Tag Coordinator will establish written Toll Tag processing procedures. Effective fiscal year 2009, Aviation Toll Tag Coordinator and Accounting personnel, in coordination with City Controller's Office personnel, will establish the receivables, the allowance for uncollectible, and the write-off in compliance Generally Accepted Accounting Principles (GAAP) and A.D. 4-10.

Implementation Date
September 30, 2009

Responsible Manager
T.K. Kasturi

Recommendation 2:

Deposit Cash Receipts in Accordance with the City's Administrative Directive

Cash receipts from 25 days were tested. Six cash receipts were not deposited within 24 hours, or one business day, of receipt as required in the City's Administrative Directive 4-13, *Cash and Debt Management Policies and Procedures*.

AVI should deposit all cash receipts within one business day according to Administrative Directive 4-13.

Management Response / Corrective Action Plan

Agree Disagree Partially Agree

Concur. Due to the implementation of SAP and departmental requirements, processing time for the Accounts Receivable section in Aviation was increased significantly. Therefore, there was a learning curve and a requirement to ensure that the deposited amounts matched what was processed in SAP. In accordance with this recommendation, Aviation Accounts Receivable section will ensure the deposit of received checks within 24 hours or one business day in accordance with Administrative Directive 4-13.

Implementation Date
August 24, 2009

Responsible Manager
Lily Lee

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Recommendation 3:

Initial Overnight Deposit Storage Log

A review of the overnight deposit storage log indicated that it was not initialed by two employees for three of the 25 days tested. According to AVI procedures, two employees are to take the overnight deposit to the safe and both employees are to initial the log each evening.

AVI should ensure that the overnight storage of cash receipts is performed by two employees who individually initial the deposit storage log.

Management Response / Corrective Action Plan

Agree Disagree Partially Agree

Concur. Aviation will ensure that the overnight storage of cash receipts is performed by two accounting employees and individually initial the deposit storage log each evening. In the absence of accounting personnel, the overnight storage of cash receipts will be performed by two authorized aviation employees who individually initial the deposit storage log.

Implementation Date

August 24, 2009

Responsible Manager

Lily Lee

Recommendation 4:

Do Not Delegate Payroll Approval by Sharing Username and Password Access

Two Supervisors delegated time approval responsibilities in the HRIS system by providing their usernames and passwords to two employees. With this access, the two employees approved their own time.

AVI should ensure supervisors do not share HRIS system usernames and passwords with employees for payroll approval.

Management Response / Corrective Action Plan

Agree Disagree Partially Agree

Concur. Aviation will ensure that supervisors do not delegate payroll approval in the HRIS system by sharing their usernames and passwords with employees.

Implementation Date

October 1, 2009

Responsible Manager

Kenneth Gwyn

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Recommendation 5:

Perform and Document the Annual Fixed Assets Physical Inventory

One hundred percent of fixed assets are normally inventoried during the annual physical inventory. For FY 2008, the annual fixed assets physical inventory was only partially completed. However, all fixed assets were reconciled to the fixed asset registry and the general ledger for FY 2008.

AVI should ensure 100 percent of the fixed assets are included in the annual physical inventory.

Management Response / Corrective Action Plan

Agree Disagree Partially Agree

Concur. Aviation accounting personnel will perform 100 percent of annual physical inventory of fixed assets effective fiscal year 2009.

Implementation Date

September 30, 2009

Responsible Manager

T.K. Kasturi

Recommendation 6:

Perform Fixed Assets Reconciliation Controls Quarterly or Semi-Annually

The internal controls related to the reconciliation of the fixed assets to the City's financial system is currently performed on an annual basis. This leaves a sizable amount of work to be performed in a short amount of time at the end of the fiscal year.

AVI Accounting personnel should consider performing the fixed assets reconciliations quarterly or semi-annually to reduce the amount of time required at year-end.

Management Response / Corrective Action Plan

Agree Disagree Partially Agree

Concur. Effective fiscal year 2010, the Aviation accounting personnel will perform the fixed asset reconciliations semi-annually.

Implementation Date

October 1, 2009

Responsible Manager

T.K. Kasturi

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Recommendation 7:

Document Storeroom Inventory Issue Log Completely

As inventory is issued to AVI personnel, a log is used to document the description of the inventory item(s), quantity, request date, and requestor signature. Testing indicated missing descriptions and / or requestor signatures on the inventory log for six of the 25 days tested.

AVI should ensure that all storeroom inventory issues are logged and the log is signed by receiving personnel.

Management Response / Corrective Action Plan

Agree Disagree Partially Agree

Concur. Previously multiple line requests for multiple items by a single Requestor were allowed to have one signature for the multiple lines. In the future, all line descriptions will be completely documented, and multiple line requests will have a diagonal line drawn across the rows for Requestor signature to clearly indicate they are checking out multiple items

Implementation Date

August 25, 2009

Responsible Manager

Jon Hooper

Recommendation 8:

Approve Storeroom Inventory Purchase Request Forms

Two purchase request forms related to storeroom over-the-counter purchases from the 15 weeks tested did not have both the Division Manager and the Assistant Director signature approval prior to placement of the order. Additionally, three purchase requests tested were not dated; therefore, we could not determine if the orders were placed prior to the Division Manager and the Assistant Director approval.

AVI should ensure that all storeroom inventory purchase request forms are approved (signed and dated) by both the Division Manager and the Assistant Director prior to the order being placed.

Management Response / Corrective Action Plan

Agree Disagree Partially Agree

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Concur. Storeroom personnel will ensure that inventory purchase request forms are approved, signed and dated by both the Division Manager and an Assistant Director prior to any order being placed. As an additional control, AVI Accounts Payable staff will be instructed to return to the Requestor any purchase requests which lack any of the required signatures.

Implementation Date
August 25, 2009

Responsible Manager
Jon Hooper

Sincerely,



Daniel T. Weber, A.A.E.
Director of Aviation

C: A.C. Gonzalez, Assistant City Manager
Dave K. Cook, Chief Financial Officer
Kenneth Gwyn, Assistant Director of Finance & Administration, Aviation
Terry Mitchell, Assistant Director of Operations, Aviation
T.K. Kasturi, Accounting Manager, Department of Aviation
Jon Hooper, Budget & Finance Manager, Department of Aviation

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