City of Denton

Meeting Agenda

Internal Audit Advisory Committee

Monday, April 29, 2024	**5:30 PM**	**Council Work Session Room**

After determining that a quorum is present, the Internal Audit Advisory Committee of the City of Denton, Texas will convene in a Regular Meeting on April 29, 2024, at 5:30 p.m. in the Council Work Session Room at City Hall, 215 E. McKinney Street, Denton, Texas at which the following items will be considered:

1. ITEMS FOR INDIVIDUAL CONSIDERATION

A. [IAAC24-005] Consider approval of minutes for July 31, 2023.

Attachments: [Exhibit 1 - Draft Minutes]

B. [IAAC24-006] Receive nominations and hold an election of a Chair and Vice-Chair

Attachments: [Exhibit 1 - Agenda Information Sheet]

C. [IAAC24-007] Hold a discussion and consider adoption of the 2024 meeting schedule.

Attachments: [Exhibit 1 - Agenda Information Sheet]

D. [IAAC24-009] Receive a report, hold a discussion, and take necessary action regarding the completion and closure of Audit Project 006 - Roadway Quality Management.

Attachments: [Exhibit 1 - Agenda Information Sheet]

[Exhibit 2 - Audit Project Completion Form - 006 Roadway Quality Management]

[Exhibit 3 - Audit of Roadway Quality Management]

[Exhibit 4 - Audit of Roadway Quality Management - Follow-Up Review]

E. [IAAC24-010] Receive a report, hold a discussion, and take necessary action regarding the completion and closure of Audit Project 007 - Accounts Payable.

Attachments: [Exhibit 1 - Agenda Information Sheet]

[Exhibit 2 - Audit Project Completion Form - 007 Accounts Payable]

[Exhibit 3 - Audit of Accounts Payable]

[Exhibit 4 - Audit of Accounts Payable - Follow-Up Review]

[Exhibit 5 - Audit of Accounts Payable - Second Follow-Up Review]

F. [IAAC24-011] Receive a report, hold a discussion, and take necessary action regarding the completion and closure of Audit Project 010 - Capital Projects Administration: Property Acquisition.

Attachments: [Exhibit 1 - Agenda Information Sheet]

[Exhibit 2 - Audit Project Completion Form - 010 Capital Projects Administration ·]

[Exhibit 3 - Audit of Capital Projects Administration - Property Acquisition]

[Exhibit 4 - Audit of Capital Projects Administration - Property Acquisition Follow-]

G.   [IAAC24-012](#)   Receive a report, hold a discussion, and take necessary action regarding the completion and closure of Audit Project 018 - Health Insurance Operations.

**Attachments:**   [Exhibit 1 - Agenda Information Sheet](#)

[Exhibit 2 - Audit Project Completion Form - 018 Health Insurance Operations](#)

[Exhibit 3 - Audit of Health Insurance Operations](#)

[Exhibit 4 - Audit of Health Insurance Operations - Follow-Up Review](#)

H.   [IAAC24-013](#)   Management Reports:
1. City Auditor's Office Fiscal Year 2023-24 Second Quarter Report
2. Fiscal Year 2022-23 Informal Follow-Up Review Report

**Attachments:**   [1. Fiscal Year 2023-24 Second Quarter Report](#)

[2. Fiscal Year 2022-23 Informal Audit Follow-Up Review Report](#)

2. CONCLUDING ITEMS

A.   Under Section 551.042 of the Texas Open Meetings Act, respond to inquiries from the Sustainability Framework Advisory Committee or the public with specific factual information or recitation of policy, or accept a proposal to place the matter on the agenda for an upcoming meeting AND Under Section 551.0415 of the Texas Open Meetings Act, provide reports about items of community interest regarding which no action will be taken, to include: expressions of thanks, congratulations, or condolence; information regarding holiday schedules; an honorary or salutary recognition of a public official, public employee, or other citizen; a reminder about an upcoming event organized or sponsored by the governing body; information regarding a social, ceremonial, or community event organized or sponsored by an entity other than the governing body that was attended or is scheduled to be attended by a member of the governing body or an official or employee of the municipality; or an announcement involving an imminent threat to the public health and safety of people in the municipality that has arisen after the posting of the agenda.

<div align="center">CERTIFICATE</div>

I certify that the above notice of meeting was posted on the official website (https://tx-denton.civicplus.com/242/Public-Meetings-Agendas) and bulletin board at City Hall, 215 E. McKinney Street, Denton, Texas, on April 24, 2024, in advance of the 72-hour posting deadline, as applicable, and in accordance with Chapter 551 of the Texas Government Code.

<div align="right">
_____

OFFICE OF THE CITY SECRETARY
</div>

NOTE: THE CITY OF DENTON'S DESIGNATED PUBLIC MEETING FACILITIES ARE ACCESSIBLE IN ACCORDANCE WITH THE AMERICANS WITH DISABILITIES ACT. THE CITY WILL PROVIDE ACCOMMODATION, SUCH AS SIGN LANGUAGE INTERPRETERS FOR THE HEARING IMPAIRED, IF REQUESTED AT LEAST 48 HOURS IN ADVANCE OF THE SCHEDULED MEETING. PLEASE CALL THE CITY SECRETARY'S OFFICE AT 940-349-8309 OR USE TELECOMMUNICATIONS DEVICES FOR THE DEAF (TDD) BY CALLING 1-800-RELAY-TX SO THAT REASONABLE ACCOMMODATION CAN BE ARRANGED.

City of Denton

City Hall
215 E. McKinney St.
Denton, Texas 76201
www.cityofdenton.com

Legislation Text

File #: IAAC24-005, **Version:** 1

AGENDA CAPTION

Consider approval of minutes for July 31, 2023.

City of Denton Internal Audit Advisory Committee

After determining that a quorum was present, the Internal Audit Advisory Committee of the City of Denton, Texas convened in a Regular Meeting on July 31, 2023, at 5:30 p.m. in the Council Work Session Room, 215 E. McKinney Street, Denton, Texas.

PRESENT: Chair Martin Mainja, Vice-Chair James Wells, and Members Michael Allison and Joshua Ingram.

1. ITEMS FOR INDIVIDUAL CONSIDERATION

A. **IAAC23-020** Consider approval of minutes for May 22, 2023.

Vice-Chair Wells moved to approve the minutes as presented; motion seconded by Member Ingram. Motion carried.
AYES (4): Chair Mainja, Vice-Chair Wells, and Members Allison and Ingram.
NAYS (0): None.

B. **IAAC23-021** Receive a report, hold a discussion, and take necessary action regarding the Fiscal Year 2023-24 Annual Internal Audit Plan.

The item was presented, and discussion followed.

Member Ingram moved to recommend all of the FY23-24 New Audit Project Options be included on the Fiscal Year 2023-24 Annual Internal Audit Plan with the exception of Airport Operations and with budgeted hours for Community Housing Initiatives and Park management & Planning reduced by 50%; motioned seconded by Member Allison. Motion carried.
AYES (4): Chair Mainja, Vice-Chair Wells, and Members Allison and Ingram.
NAYS (0): None.

Member Ingram moved to approve the FY23-24 Follow-Up Review Options as presented; motion seconded by Vice-Chair Wells. Motion carried.
AYES (4): Chair Mainja, Vice-Chair Wells, and Members Allison and Ingram.
NAYS (0): None.

C. **IAAC23-022** Management Reports
   1. Internal Audit Fiscal Year 2022-23 Third Quarter Performance Report
   2. City Auditor's Office Fiscal Year 2022-23 Tentative Project Schedule

The item was presented, and discussion followed.

2. CONCLUDING ITEMS

With no further business, the meeting was adjourned at 6:07 p.m.

_____   _____
Martin Mainja   Madison Rorschach
Chair   Interim-Recording Secretary

MINUTES APPROVED ON: _____

City of Denton

City Hall
215 E. McKinney St.
Denton, Texas 76201
www.cityofdenton.com

Legislation Text

File #: IAAC24-006, **Version:** 1

AGENDA CAPTION

Receive nominations and hold an election of a Chair and Vice-Chair

City of Denton

AGENDA INFORMATION SHEET

DEPARTMENT: **City Auditor's Office**

CITY AUDITOR: **Madison Rorschach**

DATE: **April 29, 2024**

SUBJECT
Receive nominations and hold an election of a Chair and Vice-Chair.

BACKGROUND
According to the City of Denton's Boards and Commissions Handbook, the chair and vice-chair are to be elected annually in January, but no later than February. Historically, Member Mainja was elected as Chair and previous Member Wells was elected as Vice Chair.

PRIOR ACTION/REVIEW (Council, Boards, Commissions)
None.

EXHIBITS
1. Agenda Information Sheet

Respectfully submitted:
Madison Rorschach, 940-349-7228
City Auditor

City of Denton

Legislation Text

File #: IAAC24-007, **Version:** 1

AGENDA CAPTION

Hold a discussion and consider adoption of the 2024 meeting schedule.

City of Denton

AGENDA INFORMATION SHEET

DEPARTMENT: **City Auditor's Office**

CITY AUDITOR: **Madison Rorschach**

DATE: **April 29, 2024**

SUBJECT
Hold a discussion and consider adoption of the 2024 meeting schedule.

BACKGROUND
Boards and Commissions of the City are required to adopt a regular meeting schedule annually.

PRIOR ACTION/REVIEW (Council, Boards, Commissions)
None.

FUTURE MEETING DATES
- Monday April 29 at 5:30 pm
- Monday July 29 at 5:30 pm
- Monday October 28 at 5:30 pm
- Monday January 27 at 5:30 pm (tentative)

EXHIBITS
1. Agenda Information Sheet

Respectfully submitted:
Madison Rorschach, 940-349-7228
City Auditor

City of Denton

City Hall
215 E. McKinney St.
Denton, Texas 76201
www.cityofdenton.com

Legislation Text

File #: IAAC24-009, **Version:** 1

AGENDA CAPTION

Receive a report, hold a discussion, and take necessary action regarding the completion and closure of Audit Project 006 - Roadway Quality Management.

City of Denton

AGENDA INFORMATION SHEET

DEPARTMENT: **City Auditor's Office**

CITY AUDITOR: **Madison Rorschach**

DATE: **April 29, 2024**

SUBJECT
Receive a report, hold a discussion, and take necessary action regarding the completion and closure of Audit Project 006 – Roadway Quality Management.

BACKGROUND
In accordance with the City of Denton Ordinance 21-2035, the Internal Audit Advisory Committee is responsible for providing oversight of the internal audit function, including monitoring follow-up on reported findings to assure corrective action is taken by management.

DISCUSSION
An audit project of the City's roadway quality management processes was originally conducted and reported to the City Council in October 2019. This audit identified several risks including inadequate quality control and assurance activities for in-house roadway maintenance projects, potential improvements to bond project planning and accounting practices, and some roadway maintenance work order data consistency issues.

Since the issuance of this audit, several significant improvements have been made to the City's procurement process including:

- Implementation of procedures to consistently document the selection and approval of street maintenance activities based on overall condition index and actual site conditions;

- Implementation of a required, standardized inspection process for street maintenance activities;

- Improved work order data including estimated install dates for old street segments, a process for updating install dates after reconstruction, and improved work order consistency due to training; and

- Certain administrative improvements to align with procurement policy requirements and streamline the Department's reporting structure.

Internal Audit generally evaluated these process improvements as part of the October 2021 and July 2023 follow-up reviews and believes that these improvements adequately address the recommendations issued as part of the original Audit of Roadway Quality Management.

RECOMMENDATION

Staff recommends approval of the attached Audit Project Completion Form and final closure of Audit Project 006 – Roadway Quality Management. These processes will continue to be considered for review annually as part of the Annual Internal Audit Plan development process.

PRIOR ACTION/REVIEW (Council, Boards, Commissions)

Aug. 20, 2019: Audit/Finance Committee recommended forwarding the Audit to City Council

Oct. 8, 2019: Audit of Roadway Quality Maintenance presented, and Project 006 closed till follow-up by Council

Oct. 12, 2021: Audit of Roadway Quality Maintenance: Follow-Up Review presented; Council directed Project 006 be closed till the performance of an informal follow-up review

Jul. 21, 2023: Fiscal Year 2022-23 Informal Follow-Up Review distributed to City Council via the Friday Report – included information on Project 006

EXHIBITS

1. Agenda Information Sheet
2. Audit Project Completion Form – 006 Roadway Quality Management
3. Audit of Roadway Quality Management
4. Audit of Roadway Quality Management: Follow-Up Review

Respectfully submitted:
Madison Rorschach, 940-349-7228
City Auditor

Audit Project Completion Form

Project Title: Roadway Quality Management   Project Number: 006

Table 1: Project Timeline

Deliverable	Responsible Staff	Audit Plan FY	Date Issued	Months to Complete	Hours to Complete
Audit Report	Madison Rorschach Umesh Dalal	FY2018-19	10/08/2019	8.50	NA
Follow-Up Report	Madison Rorschach Amber Jackson	FY2019-20	10/12/2021	1.00	NA
Informal Follow-Up Report	Madison Rorschach Amber Jackson	FY2022-23	07/21/2023	NA	6.50
			Total:	**9.5**	**6.50**

Concurrent Rate: _____ 100% _____   Implementation Rate: _____ 100% _____

Table 2: Project Recommendation Summary

Recommendation	Mgmt. Response	Status
1. Develop a standardized process for recording and approving design adjustments to in-house street rehabilitation projects.	Concur	Implemented
2. Develop a record retention system to store inspection reports and geotechnical reports for each street rehabilitation project according to the Texas State Library and Archives Commission's regulations.	Concur	Implemented
3. Require Streets Field Services Supervisors to submit periodic inspection reports as part of the quality acceptance decision-making process for street rehabilitation projects.	Concur	Implemented
4. Consider including street connectors in bond program proposals in the future to better estimate costs and provide greater transparency to residents.	Concur	Implemented
5. Develop a process to consistently document the street segments included in each project.	Concur	Implemented
6. Finance should consider accounting for each general obligation bond series in a separate fund.	Partially Concur	Implemented
7. Include up-to-date installed date information in the Cartegraph system.	Partially Concur	Implemented
8. Consider adjusting the amount of OCI points added to a street segment for overlays.	Partially Concur	Implemented
9. Provide training for crew leaders entering work order information	Concur	Implemented

10.	Check the Texas State Comptroller's website for related historically underutilized businesses when obtaining quotes for purchases between $3,000 and $50,000.	Concur	Implemented
11.	Contract for the rental of signs and barricades to mark road construction sites.	Concur	Implemented
12.	Revise the Streets Operations Manager and Streets & Traffic Superintendent job descriptions to more accurately reflect current job responsibilities.	Concur	Implemented

Based on the project timeline and recommendation summary listed previously, the City Auditor recommends this project be closed and considered formally complete:

City Auditor: _Madison Rorschach_   Date: __07/31/2023__

AUDIT OF ROADWAY
QUALITY MANAGEMENT

ABSTRACT

Roadway improvement resources appear to be used equitably throughout the City; however, documentation of roadway quality controls is lacking. This audit recommends improvements to increase assurance over roadway quality and provides suggestions to more efficiently provide roadway services.

City Auditor's Office

Table of Contents

Executive Summary

Honorable Mayor and members of the City Council,

The City Auditor's Office has completed a performance audit of the roadway quality management process. This was a scheduled audit on the FY 19 audit plan approved by the City Council. The Streets Division of the Public Works Department is currently responsible for maintaining and improving a little under 1,400 lane miles of roadway. Between fiscal years 2014 and 2018, an average of $11 million dollars was expended annually from the Streets Improvement Fund.

The following are our salient findings:

- The Street division has planned rehabilitative activities and roadway improvements based on needs for these services. This planning process results in ensuring sound decisions for appropriately maintaining street infrastructure.
- The controls over ensuring the quality of contractor and in-house road rehabilitation projects for meeting established standards need improvement. We verified that about 1.63 lane miles of road were overlaid instead of being fully reconstructed as indicated by Overall Condition Index (OCI) guidelines and consultant's recommendation (see Table 4). We did not find appropriate documentation for deviating from these guidelines and recommendations. Evidence for approval of these actions was not available. Furthermore, without retaining design standards or materials testing results provided by the geotechnical engineer, compliance with the City's quality standards cannot be assured after the project is complete. Similarly, there was no reviewable documentation of Field Services Supervisor's inspections to assure compliance with standards.
- The current practice of accounting proceeds of multiple General Obligation (GO) bond issues in one GO Streets fund hinders the tracking of project expenditures back to bond series. More consistent and precise accounting of each bond series' proceeds may increase transparency and accountability.
- Thirty-nine overlay work orders were completed on street segments with an inspected OCI less than 30 indicating a need for reconstruction. This is because low OCI indicates the integrity of the underlying layers of the roadway may be failing. The OCI score was raised from under 30 (street in poor condition) to 85 (a street in very good condition) with overlay activity, which is much limited to reconstruction. This action could provide misleading information for future need for maintenance or improvements on these segments.

Management has concurred with 9 of 12 recommendations made in this report and partially concurred with the remaining three. Management's response is attached to this report in Appendix A. We appreciate staff's cooperation during the audit. Please contact the City Auditor if you have any questions or need more information.

Sincerely,

Umesh Dalal, City Auditor

Introduction

The City Internal Auditor is responsible for providing: (a) an independent appraisal of City operations to ensure policies and procedures are in place and complied with, inclusive of purchasing and contracting; (b) information that is accurate and reliable; (c) assurance that assets are properly recorded and safeguarded; (d) assurance that risks are identified and minimized; and (e) assurance that resources are used economically and efficiently and that the City's objectives are being achieved.

The City Auditor's Office has completed a performance audit of the roadway quality management process. We conducted this performance audit in accordance with generally accepted government auditing standards with the exception of standard 4.18 regarding documentation of audit staff's continuing professional education.[1] 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.

Management Responsibility

City management is responsible for ensuring that resources are managed properly and used in compliance with laws and regulations; programs are achieving their objectives; and services are being provided efficiently, effectively, and economically.

Audit Objectives, Scope, and Methodology

This report is intended to provide assurance on the City's ability to:

- Maintain and improve the City's roadway network economically and efficiently; and
- Properly record and safeguard one of the City's largest and most valuable assets (streets) by evaluating the effectiveness of controls over:
  - o The quality assurance process of street improvements; and
  - o The management and monitoring of pavement condition.

Audit fieldwork was conducted during March and April of 2019. The scope of review varied depending on the procedure being performed. The following list summarizes major procedures performed during this time:

- Reviewed documentation to develop criteria including industry standards, best practices, policies, and procedures;
- Developed a process narrative to identify current control activities, which was certified by the Streets Superintendent;
- Evaluated the methodology and functionality of Streets' pavement management system;
- Reviewed the documentation associated with all fiscal year 2018 Streets' purchase orders to determine if applicable bidding laws were followed;
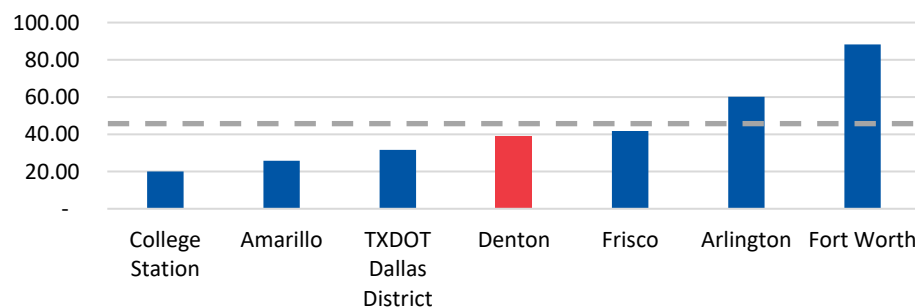
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[1] This report was amended on February 15, 2022 to disclose this exception, the details of which were communicated to the City Council in a Staff Report publicly issued on February 11, 2022.

- Analyzed Streets' work orders completed during 2016-2018;

- Investigated the implementation of the 2012 and 2014 street rehabilitation bond programs; and

- Interviewed City staff and observed some meetings to better understand Streets' project clearance process.

Background Information

The City of Denton's Streets Division of the Public Works Department is currently responsible for maintaining and improving a little under 1,400 lane miles of roadway. Between fiscal years 2014 and 2018, an average of $11 million dollars was expended annually from the Streets Improvement Fund. In addition to these monies, citizens approved $44 million of bond issues via election in 2012 and 2014 to fund the rehabilitation of certain streets throughout the City. Compared to similar organizations, the Division's staffing level is about average by lane miles.
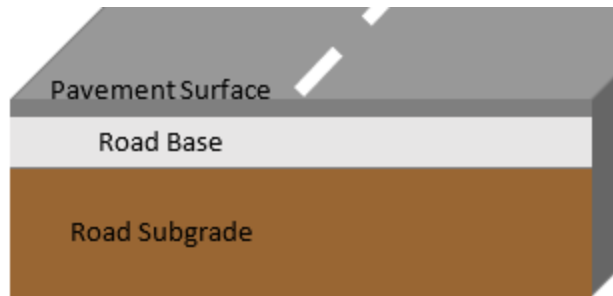
Figure 1: Staffing Comparison – Lane Miles per Full Time Equivalent

No matter how well constructed, a roadway will deteriorate over time due to the effects of traffic loads and the environment. Roadway maintenance and improvements are used to slow down or reset this deterioration process. Generally, there are three different classifications of roadway maintenance and improvements that are further described below. Each of these maintenance and improvement techniques are useful at different points in the pavement's life cycle and typically cost decreasing amounts of money from rehabilitative to corrective to preventative techniques.

Rehabilitative improvements repair portions of an existing pavement to reset the deterioration process. The City uses asphalt overlays and concrete panel replacements to rehabilitate the pavement surface of a road. An overlay involves milling away the existing pavement surface and then laying new asphalt to repave the roadway. Similarly, a panel replacement removes the existing concrete pavement and replaces it with a new panel.

The reconstruction of a roadway involves the stabilizing and compacting of the naturally occurring material, called the subgrade. Additionally, a base layer, typically made of compacted aggregate material, may be added on top of the subgrade to further improve the structure's integrity. Finally, the pavement surface is lain to protect these underlying pavement layers (see Picture 1).

Picture 1: *Simplified Roadway Cross Section*

Corrective maintenance helps to slow the rate of deterioration by repairing localized failures of the underlying layers. Specifically, the City repairs potholes, utility cuts, and base failures through the use of patching and level ups. Patching and level ups involve replacing an area of the pavement surface with new material after repairing an underlying deficiency. While patching is a maintenance technique, it weakens the pavement's surface and cannot fully replicate the integrity of the original road's structure. These weaknesses can only be corrected through rehabilitative improvements such as milling and overlay techniques.

Preventative maintenance and improvements help to slow the rate of deterioration by addressing minor deficiencies on the pavement surface caused by the passage of time. Specifically, the City utilizes crack sealing and micro sealing techniques to prolong the useful life of a pavement. Crack sealing is the process of individually filling cracks along the pavements surface to prevent the entry of water, weeds, rocks, etc.; a similar technique, called joint sealing, may be used for concrete pavements. These techniques help to prevent the deterioration of the roads underlying layers. Micro sealing is the process of adding a thin layer of asphalt to an existing pavement surface, extending the useful life of that surface; this technique is also considered a roadway improvement.

What Works Well?

Throughout this report, the City's controls over the quality assurance of roadway rehabilitation and pavement condition management and monitoring have been compared to the City's policies and procedures and pavement management best practices compiled by Pavement Interactive. Pavement Interactive is a curated information resource for the pavement community, which provides a reference on common pavement topics, methods, and practices. Pavement Interactive was developed by the Pavement Tools Consortium, a partnership between several state Department of Transportations,[2] the Federal Highway Administration, and the University of Washington, as part of their effort to further develop and use computer-based pavement tools.

Street Design Standards Address Critical Design Parameters

According to Pavement Interactive, there are three fundamental design parameters to consider during street construction or rehabilitation: 1) subgrade characteristics, 2) traffic loads, and 3) environmental factors. Pavement design standards must be met to provide the pavement useful life expected by the owning agency. The auditors found the following:

- Pavement standards were designed by an engineering consultant based on a 20-year useful life for asphalt streets and 40-year useful life for concrete streets and codified in the Transportation Design Criteria Manual.

- Design standards are based on street classifications (i.e. arterial, collector, etc.) which are determined by traffic loads.

  - Standards define street minimum and maximum grading, minimum subgrade stabilization depth, minimum pavement thickness, and minimum steel bar reinforcement size.

- City Ordinance requires all street improvements to comply with the street design specifications contained in the Transportation Design Criteria Manual.

The Pavement Management System Provides for Equitable Use of Resources

Pavement Interactive defines a pavement management system as the "concept of providing pavements and maintaining them in acceptable condition" and identifies five key components of a management system. These components include: 1) pavement condition survey, 2) pavement information database, 3) pavement analysis scheme, 4) decision criteria, and 5) implementation. The auditors found the following:

- The City of Denton hires a consultant about every five to six years to identify an overall condition index (OCI) number for each street segment (similar to a block). The most recent consultant used a pavement assessment methodology that conforms to best practices and was similar to that of benchmark municipalities.

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[2] The Texas Department of Transportation was a part of this Consortium.

o The OCI is based on the size of visible pavement distresses, road roughness, and – for collectors[3] and above – the street's structural integrity based on samples of the underlying layers of roadway.

- The inspected OCI of each street segment is maintained in the City's pavement management software. This software depreciates the OCI as time passes based on the pavement's subgrade strength and traffic load. In addition, it accounts for maintenance and improvement activities completed by the Division.

- This estimated OCI is then used to determine when and where maintenance and improvement techniques should be used based on guidelines provided by the pavement management survey consultant. This practice helps to ensure resources are used equitably throughout the City.

  o Similarly, the Streets Division typically identifies street segments with very-low OCIs to be targeted as part of street rehabilitation bond programs.

  o Pictures 2 and 3 below compare planned roadway improvement activities to the current condition of the City's roadway network based on the estimated OCI. These pictures illustrate a connection between planned rehabilitative activities and roadway improvement needs based on estimated OCI.
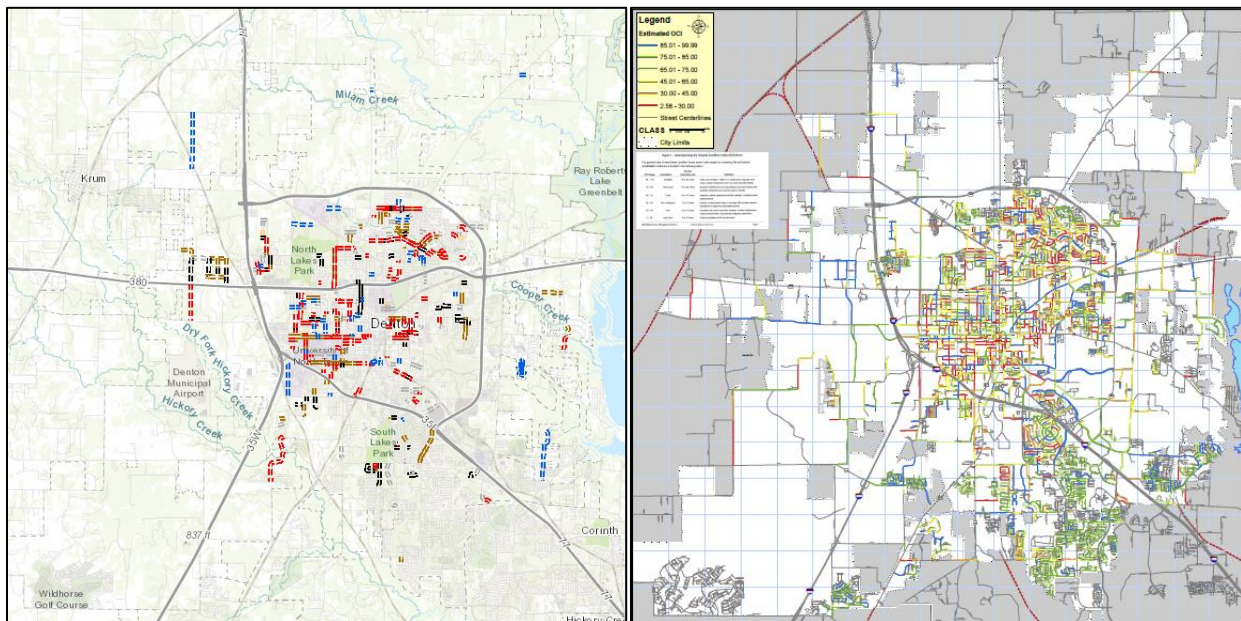
Picture 2: Planned Improvements

Picture 3: Road Quality

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[3] "Collector streets" collect the associated traffic from residential and rural streets, commercial streets, or industrial streets.

Coordination Between Streets & Utilities is Improving

Utility lines are typically placed alongside or under the City's roadways; however, this means that it is frequently necessary to remove sections of roadway for a utility to perform work on their assets. Therefore, agencies should coordinate their maintenance and improvement activities to most efficiently and effectively provide both utility and roadway services to residents. The auditors found the following:

- The City has developed a process to clear street improvement projects (i.e. micro seals, overlays, and reconstructs) through the City's Water Utilities Department and Atmos Energy.[4] Clearing a project may require the utility to replace or repair their utility lines before Streets can begin their work.

  o The Wastewater Department uses an algorithm to identify necessary repair actions to take before clearing a street project. This algorithm takes into account planned repairs, repair history, current inspection information, choke or clog history, and a pipe-risk index.[5]

  o The Water Department determines necessary repair actions manually based on pipe age and breakage rates. Water is currently developing a similar algorithm to Wastewater's which should further improve effectiveness.

  o After clearance, roadway improvement activities are performed, and the corresponding street segments are placed under a moratorium, as determined by Streets Division practices, for the periods defined in Table 1.

Table 1: Moratorium Periods

Improvement	Moratorium
Micro Seal	3 Years
Overlay	7 Years
Reconstruct	12 Years

- In addition to this clearance process, monthly coordination meetings are held to help facilitate communication between City departments and external utilities. At these meetings scheduling and status information about each entity's current projects is discussed.

- There has not always been a focus on the coordinated scheduling of utility and street projects; however, this has recently been changing as the Water, Wastewater, and Streets Divisions have developed their own construction schedules. While these scheduling efforts are still being integrated and refined, they should increase efficiency moving forward.

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[4] These utilities accounted for about 97% of all utility street cuts in 2018.

[5] Wastewater pipe-risk is based on breakage rates, tree root density, and other factors.

Page 9

Opportunities for Improvement

Between 2016 and 2018, the City's Streets work order system – Cartegraph – recorded a total cost of almost $19.7 million; street maintenance and improvement techniques made up about 77% of these expenditures, which are broken out by activity type in Table 2. These activities are paid through several funding sources including general obligation bond revenues and the Streets Improvement Fund operations and maintenance budget.

Table 2: Maintenance & Improvement Cost Breakdown (2016-2018)

Preventative Techniques	Total Cost
Crack Sealing	$171,000
Micro Sealing	$1,743,000
All:	*$1,914,000*
Corrective Techniques	**Total Cost**
Level Ups	$214,000
Potholes	$412,000
Utility Cuts	$1,004,000
Base Failures	$1,945,000
All:	*$3,575,000*
Rehabilitative Techniques	**Total Cost**
Mill & Overlays	$3,988,000
Reconstructs	$5,691,000
All:	*$9,679,000*
All Techniques	*$15,168,000*

Roadway Rehabilitation Quality Cannot Always be Assured

According to Pavement Interactive, there are generally three components to quality assurance[6] consisting of, 1) quality control (QC), performed by those doing the work; 2) independent assurance (IA), performed by an unrelated third-party; and 3) quality acceptance (QA), performed by the owning agency. Acceptance activities include the sampling, testing, and assessment of test results to determine whether construction meets the design specifications.

Inspectors monitor and observe the construction of roads and typically file daily reports for their supervisors to review as part of the acceptance process. Pavement Interactive specifies that inspectors must be in a separate chain of command from the crews who are building the roads to ensure appropriate segregation of duties. If this is not possible, compensating controls should be designed to ensure quality standards are met. A well-designed quality assurance process decreases the likelihood that street improvements do not meet their expected useful life, which would require more maintenance faster than expected.

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[6] Quality assurance is defined as those planned and systematic actions necessary to provide confidence that a product or facility will perform satisfactorily in service, including continued evaluation of all activities in the process.

What We Found?

- Quality control activities (i.e. street construction activities) may be performed by either in-house Streets Division crews or contractor crews. Both types of crews are required to conform to the City's Transportation Design Criteria Manual.

Controls Over Contractor Crews

- A third-party civil engineer provides construction plans or design minimums for contracted reconstructs.

- A separate third-party geotechnical engineer tests the quality of rehabilitation construction materials upon request of the City.

- Field Services Supervisors record inspection results in their personal project journals and verbally communicate any project issues to Streets upper management and contractor crew leaders. Inspection reports are not physically documented.

- Contracted work orders are closed by the Project/Construction Coordinator after the submitted invoice has been reviewed by the Field Services Supervisor.

Controls Over In-House Crews

- A third-party geotechnical engineer typically provides design minimums for in-house rehabilitations; design decisions are occasionally made by Field Services Supervisors when a geotechnical engineer is not engaged.

- Typically, the same third-party geotechnical engineer tests the quality of rehabilitation construction materials upon request of the City.

- Field Services Supervisors record inspection results in their personal project journals and verbally communicate any project issues to Streets upper management and in-house crew leaders. Inspection reports are not physically documented.

- In-house work orders are then closed by the Field Services Supervisor or the Crew Leader.

Available Documentation of Quality

- OCI maintenance guidelines promulgated by the City's pavement survey consultant suggest the following maintenance and improvement techniques (see Picture 4).

OCI Range	Description	Relative Remaining Life	Definition
85 – 100	Excellent	15 to 25 Years	Like new condition – little to no maintenance required when new; routine maintenance such as crack and joint sealing.
75 – 85	Very Good	12 to 20 Years	Routine maintenance such as patching and crack sealing with surface treatments such as seal coats or slurries.
65 – 75	Good	10 to 15 Years	Heavier surface treatments and thin overlays. Localized panel replacements.
45 – 65	Fair to Marginal	7 to 12 Years	Heavy surface-based inlays or overlays with localized repairs. Moderate to extensive panel replacements.
30 – 45	Poor	5 to 10 Years	Sections will require very thick overlays, surface replacement, base reconstruction, and possible subgrade stabilization.
0 – 30	Very Poor	0 to 5 Years	High percentage of full reconstruction.

Picture 4: *OCI Guidelines*

Page 11

- o These definitions were used to develop the criteria shown in Table 3. These criteria were applied to the average inspected OCI of about $11.4 million of street improvement projects to target projects for review.[7] Maintenance techniques were not reviewed because they are generally localized projects that do not impact the OCI of the whole street segment.

Table 3: Targeted Review Criteria

Improvement Activity	Project Average Inspected OCI
Micro Seal	Below 45
Mill & Overlay	Below 30
Reconstruct	Above 50

- Based the criteria in Table 3, we selected no micro seal projects, 9 mill & overlay projects, and 15 reconstruction projects[8] for targeted review. These selected projects totaled about $2.1 million dollars (i.e. 18% of street improvement project work order costs); about half of this amount was spent via contract. After reviewing the available supporting documentation for these projects, we found the following:

  - o About $141,000 of rehabilitative activities on 1.63 lane miles of roadway had documentation that supported an alternative action being taken – specifically the road was overlaid instead of reconstructed. There was no management approval of these unsupported actions documented.

    - ▪ About 87% of these unsupported expenditures were made in contradiction to the opinion issued by the geotechnical engineering company. The remaining amount appear to have been overlaid in response to pressure from residents, however, they were scheduled to be reconstructed as part of the bond program.

Table 4: Summary of OCI Rehabilitation Exceptions Documentation (2016-2018)

Audit Determination[9]	Reconstruct Amount	Overlay Amount	Total Amount
Unsupported	$0	$141,000	$141,000
Lack of Design Standards	$197,000	$102,000	$299,000
Supported	$1,619,000	$44,000	$1,663,000
All OCI Exceptions:	*$1,816,000*	*$287,000*	*$2,103,000*

  - o Relevant materials testing results prepared by the City's geotechnical engineer could not be provided for three of fifteen reconstruction projects and seven of nine overlay projects about $443,000.

  - o Quality inspection documentation could not be provided for any of these projects.

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[7] A project was determined by matching multiple street segment street names, activities completed, and dates completed.

[8] Two of these reconstruct projects used mill & overlay activity codes, however, we were able to verify that they were reconstructed.

[9] An activity was determined to be unsupported if there was documentation that a different action had been recommended. Those projects identified as part of a bond program or bond program "connectors" were determined to be supported.

Why Does It Matter?

Table 5 summarizes the controls currently being performed to ensure the quality of contractor and in-house road rehabilitation projects meets standards; the current control deficiencies exist:

a. Field Services Supervisors occasionally make decisions contrary to geotechnical engineer design recommendations (QC step in Table 5). Justification or support for these decisions is not adequately documented (see Table 4).

b. Design standards and materials testing results prepared by the geotechnical engineer are not always retained by the Division (IA step in Table 5).

c. The Field Services Supervisor's quality inspections of contractor and in-house rehabilitation projects are not documented in a reviewable form (QA step in Table 5).

Table 5: Quality Assurance Controls over Road Rehabilitations

Step	Control Activity	Contractor	In-House
QC	Design Standards	Civil Engineer	Geotechnical Engineer or Field Services Supervisor
	Crew Supervision	Crew Leaders	Crew Leaders
IA	Materials Testing	Geotechnical Engineer	Geotechnical Engineer
QA	Quality Inspections	Field Services Supervisor	Field Services Supervisor
	Quality Acceptance	Field Services Supervisor	Field Services Supervisor or Crew Leaders
	*Risk Level: ***	High	High

*Risk that roadway improvements will not comply with the City's standards.

Adequate Assurance of Compliance
Some Assurance of Compliance
Little Assurance of Compliance

We verified that about 1.63 lane miles of road were overlaid instead of being fully reconstructed as indicated by OCI guidelines and a geotechnical engineer's recommendation. While there may be justification for these decisions there is not documentation available to show appropriate approval of these actions. Furthermore, without retaining design standards or materials testing results provided by the geotechnical engineer, compliance with the City's quality standards cannot be assured after the project is complete. Similarly, there is no reviewable documentation of Field Services Supervisor's inspections, meaning there is little assurance that standards are being met.

These documentation issues prevent independent determination of a rehabilitation project's compliance with the City's standards. If projects are not constructed to standards, they may not meet the expected useful life – potentially costing the City more money more quickly than expected. Without more complete documentation, our Office cannot provide assurance on the quality of rehabilitation projects, even if the activity aligns with OCI guidelines.

Recommendations (High Priority):

1. Develop a standardized process for recording and approving design adjustments to in-house street rehabilitation projects. While not all projects need to have engineered design minimums, adjustments to these minimums need to be approved by Streets management.

   Public Works Comments: Staff will implement process controls for deviation from recommendations. This will include written documentation escalated and signed by

management to approve the deviation. SOPs (standard operating procedures) will be created and all employees will be trained on the process.

2. Develop a record retention system to store inspection reports and geotechnical reports for each street rehabilitation project according to the Texas State Library and Archives Commission's regulations.

   Public Works Comments: *Staff will establish SOPs (standard operating procedures) for record retention. Cartegraph, our internal work order system, can be structure so that all pertinent documents to the specific job are stored in the system and reports can be run to retrieve the data.*

3. Require Streets Field Services Supervisors to submit periodic inspection reports as part of the quality acceptance decision-making process for street rehabilitation projects.

   Public Works Comments: *Standardized inspection documentation will be created and implemented. These documents will be specific to the work being performed, (mill and overlay, micro seal, reconstruction, etc.), archived in the Cartegraph system, and tied to the work order. SOPs (standard operating procedures) will be created and all employees will be trained.*

Changes to Street GO Bond Administration Could Further Enhance Transparency

In order to facilitate the rehabilitation of the City's roadway network, citizens approved $44 million of general obligation (GO) bond issues via election in 2012 and 2014 to fund the rehabilitation of streets throughout the City. The use of GO bonds is intended to increase transparency as only those expenditures authorized via the bond election can be funded with GO revenues.

What We Found?

Bond Program Planning

- When developing street propositions for GO bond elections, the Streets Division has typically identified street segments with very-low OCIs as rehabilitation targets and advertised these areas as part of the election materials.

  - The Division's progress on completing these areas is monitored by the City's Bond Oversight Committee, which is composed of five Denton citizens who are appointed by the City Council. As of April 2019, the rehabilitation of about 56% of lane miles identified in the 2012 and 2014 bond programs has been completed. Figure 2 shows the current status of these lane miles in more detail.[10]

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[10] Appendix B details the street segments that are remaining (i.e. no progress has been made towards their rehabilitation).

Figure 2: 2012 & 2014 Street Rehabilitation Bond Program Status
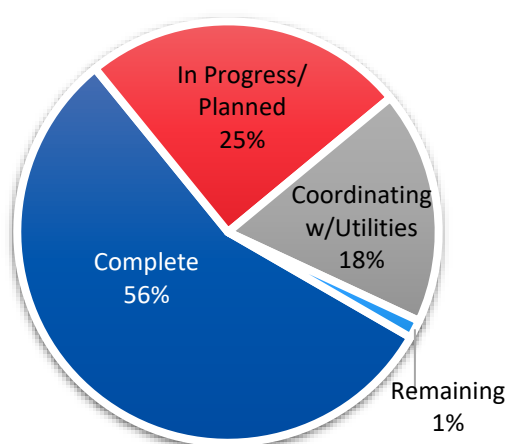
Status	Segments	Lane Miles
Complete	226	72.8
In Progress/Planned	99	32.4
Coordinating w/Utilities	72	23.4
Remaining	6	1.8
All:	403	130.4

- Street segments near or in between the very-low OCI segments with higher OCIs – called "connectors" – were not included as part of the bond program in these advertised materials.[11]

    o However, current Division practices typically include these connectors in rehabilitation projects, especially if the segments are all located in one neighborhood or will be disturbed by utilities.

    o While not all rehabilitation costs are part of bond programs, about 35% of our $2.1 million of projects targeted for documentation review (i.e. Table 4)[12] were "connectors" and about 41% were identified as part of the bond program in the advertised materials.

Bond Program Accounting

- General obligation bond funds from different elections are currently co-mingled in one fund by business unit. For example, the revenues from $44 million of 2012 and 2014 approved bond issues are recorded in one GO Streets fund; GO revenues and associated expenditures for a separate business unit, such as Parks, are recorded in a separate fund

- Street project descriptions do not always clearly specify the street segments included in the project's scope. Additionally, project numbers are not always included in Cartegraph. These practices hinder the tracking of bond expenditures to specific rehabilitation work.

Why Does It Matter?

Bond Program Planning

As mentioned previously, selecting street segments to be targeted as part of a bond program using the very-low OCI criteria is an appropriate practice that helps ensure resources are used equitably throughout the City. However, not considering connectors in bond program planning requires the Streets Division to spend more money than anticipated on these projects to remain effective; not planning for these connectors means either:

    I.   Money from the operational fund must be spent to supplement the bond program; or

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[11] According to staff, planning for the 2019 GO election will consider street connectors when identifying streets for rehabilitation.

[12] This information is included for reference and should not be taken as a reflection of all Streets rehabilitation activities.

II.   General obligation bond revenues must be spent to rehabilitate fewer lane miles.

Bond Program Accounting

The City's current project accounting method is appropriate for tracking expenses related to each street rehabilitation and provides adequate transparency to the Bond Oversight Committee; however, consistent and specific project documentation would facilitate tracking GO bond fund expenditures. Similarly, accounting for both the 2012 and 2014 bond revenues in one GO Streets fund hinders the tracking of project expenditures back to bond series. More consistent and precise accounting of bond revenues and expenditures would further enhance transparency and accountability.

Recommendations:

4. Consider including street connectors in bond program proposals in the future to better estimate costs and provide greater transparency to residents.

    Public Works Comments: *Staff will recommend implementing this practice to the Bond committee. The ultimate decision is left up to the committee. Staff will follow Bond Committee and City Council direction.*

5. Develop a process to consistently document the street segments included in each project.

    Public Works Comments: *Staff will restructure the intake portion of the workorder system to more efficiently tie street segments together on larger jobs. SOPs (standard operating procedures) will be created and all employees will be trained in the new process.*

6. Finance should consider accounting for each general obligation bond series in a separate fund.

    Finance Comments: *The consolidation of bond funds was implemented in 2014 to streamline the tracking of project costs and expenses of bond proceeds. Among other benefits, consolidation limits the number of funds necessary to account for project construction costs. The City's Bond Counsel approved of consolidation, and the City's annual external audits have approved capital projects expenditures related to bond related projects.*

    Following the approval of a new bond program, staff will consider all options for bond fund accounting.

Data Issues Impede Pavement Monitoring Effectiveness

As mentioned previously, a pavement management system typically has five components including a pavement information database. This database should allow the user to view and manipulate pavement data in a meaningful way. The City's database is stored in its Cartegraph system which contains two types of pavement information: 1) street asset information by segment and 2) maintenance and improvement work order information.

What We Found?

Street Segment Asset Information

- Street segment asset information is generally complete and accurate; however, the installed date of most assets was not up-to-date.

- This data is currently stored in the City's geographic information system (GIS). According to staff, Streets is working with Technology Services to link this data to Cartegraph.

- Certain work order activities increase the OCI of the associated asset. These point increases are set by the City's OCI consultant based on their professional judgment.

  - We believe these point increases are generally appropriate with the exception of overlay work orders, which may result in overestimating the overlays effectiveness – especially for lower OCI assets. Table 6 shows the point increases.

Table 6: Street Asset OCI Updates by Work Order Activity

Activity	OCI Increased To	Activity	OCI Increased By
Reconstruct	100	Micro Seal	10%
Overlay	85	Crack Seal	7%

- Visual inspection and analysis of estimated OCI data found that about 228 work orders completed between 2016 and 2018 did not properly update the asset's OCI.

  - After communicating this information to staff, they found that there were issues in Cartegraph's update formula. This issue has since been corrected – increasing the City's roadway network's average estimated OCI by about half a point.

Work Order Information
- The Cartegraph work order system had 6,847 completed work orders recorded at the beginning of our audit period. These work orders finished construction between May 2015 and February 2019, and about 56% appear to be directly related to street maintenance or improvements. The auditors found:

  - A total of 83 different work order activity codes are recorded in the City's work order data. Some of these activities are obsolete, duplicates of other activities, or steps in a different activity's process. These redundancy issues appear to have improved over time from 68 activity codes in 2016 to 49 in 2018; however, they still complicate attempts to analyze activity costs over this period.

  - Over 5% of completed work orders do not have a construction start date, however, only one work order was missing a construction stop date. It is unclear why these start dates are omitted.

  - Almost 7% of completed work orders do not have any related cost information; of these work orders, 163 (about 2% of completed work orders) were directly related to street maintenance or improvements.

Why Does It Matter?

Without installed date information, the Division is not able to conduct analysis on the useful life of pavements to identify potential issues in the City's standards or pavement quality. In addition, without consistent work order information such as activity, cost, start dates, and stop dates, the City cannot conduct effective cost analysis.

Similarly, 39 overlay work orders were completed on street segments with an inspected OCI less than 30, which would indicate a reconstruction is more appropriate, typically because the integrity of the underlying layers of the roadway are failing. If the underlying integrity of these segments was failing, increase the OCI to 85 – or very good condition – could lead to the segment not receiving needed maintenance or improvements.

In summary, without capturing adequate data, the City cannot effectively monitor the condition of its roadway network. While the deficiencies noted previously do not prevent monitoring, the effectiveness of the Division will be enhanced through more accurate, consistent, and complete data entry and analysis.

Recommendations:

7. Include up-to-date installed date information in the Cartegraph system.

   Public Works Comments: Staff will work with IT to update the installed date for older infrastructure pulling information from GIS. While the install date is important it is not vital. With regular pavement studies the street condition is evaluated at that time and a maintenance plan is established on the current condition.

8. Consider adjusting the amount of OCI points added to a street segment for overlays. Increasing the OCI by a percentage, similarly to micro seals and crack seals, may be more appropriate for lower OCI streets than increasing the OCI to a flat 85 which is the current practice.

   Public Works Comments: Staff will discuss the recommendation with the Pavement survey contractor. All performance curves and OCI adjustments after completion of work is a base line set by pavement analysis company. This company will be conducting another survey in the next fiscal year and will reevaluate at that time.

9. Provide training for crew leaders entering work order information into the Cartegraph system. The training's content should be focused on generating data that will be useful for the Division when analyzing the cost of work orders and useful life of assets and should be informed by management's needs.

   Public Works Comments: Staff will create SOPs (standard operating procedures) and all employees will be trained on the process of work order entry.

Potential Cost Savings May Exist in the Purchasing Process

In order to protect its residents from misappropriation or malfeasance of municipal funds, Texas state law requires different bidding requirements at differing levels of purchases.[13] These requirements are summarized in Table 7; however, it should be noted that there are some exceptions, which are outlined in Texas Local Government Code Section 252.002.

Table 7: Texas Purchasing Law Summary

Greater than $50,000	• Invite competitive sealed bidding • Award a contract to the lowest responsible bidder
Between $3,000 & $50,000	• Acquire at least three quotes • Contact at least two historically underutilized businesses (HUB)
Less than $3,000	• None

What We Found?

- During 2018, a total of $14.9 million dollars purchase orders were issued from the Streets Improvements Fund. About $14.5 million of this amount was covered under a contract. The remaining $408,868 were spent as shown in Table 8.

- Based on a review of available documentation, the Division purchased two commodities – totaling $40,977 – without obtaining three quotes or having adequate exception documentation.

    o Documentation showed that $31,117 of this amount was spent on purchases of lime after the previous contract had expired. A new contract was executed later that year.

    o The other $9,860 for railroad signal maintenance may be a sole source exception, however, there is not adequate documentation to verify this conclusion.

- We identified one commodity that had a relevant historically underutilized business; a quote was not obtained from this vendor and there was no documentation that they were contacted.

- Eight purchase orders issued during 2018 were for the rental of signs and barricades to mark road construction areas. These purchases – made for different constructions sites – total more than $50,000.

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[13] Texas Local Government Code prohibits the use of "separate, sequential, or component purchases" as a means of avoiding bidding requirements.

Table 8: Streets Improvement Fund Purchases without a Contract

Commodity	Compliant?	Total Purchases
Sign & Barricade Rentals	Contract Needed	$89,894
Materials Disposal	HUB Quote Missing	$50,000
Sampling	Yes	$50,000
Guard Rails	Yes	$49,000
Backhoe Rental	Yes	$38,743
Patching Material	Yes	$35,700
Lime	Quotes Needed	$31,117
Skid Steer Loader Rental	Yes	$30,032
Signal Maintenance	Quotes Needed	$9,860
Heavy Equipment Purchase	Yes	$8,371
Professional Service	Exempt	$7,500
Light Tower Rental	Yes	$4,700
Tree Trimming	Yes	$2,950
Training	Yes	$1,000
	All:	$408,868

Why Does It Matter?

Without proper documentation, we cannot determine if the City has completely complied with Texas law for about $40,977 of purchases; however, these issues have been addressed in a separate audit of Procurement. This being said, departments are responsible for obtaining quotes when purchases are between $3,000 and $50,000 according to the City's Materials Management & Payment Procedures Manual – meaning the Streets Division must ensure compliance with Texas law regarding historically underutilized businesses.

Finally, sign and barricade rentals totaled more than $50,000, which is a violation of state law. The City should contract for these purchases in order to comply with state law going forward. In addition, the City may be able to save money on these expenditures through the contracting process.

Recommendations:

10. Check the Texas State Comptroller's website for related historically underutilized businesses when obtaining quotes for purchases between $3,000 and $50,000.

    Public Works Comments: Staff has been trained on the correct process for properly quoting jobs. Continued education will continue as other Purchasing procedures are updated.

11. Contract for the rental of signs and barricades to mark road construction sites.

    Public Works Comments: Contract was approved by City Council June 18th.

Current Management Structure Indicates Redundancy

Responsibility should be assigned to discrete units of an organization to operate in an efficient and effective manner according to the Government Accountability Office's Standards for Internal Control. During the audit period, Streets was a division of Capital Projects under the operations

side of the department; the Traffic and Drainage divisions were also a part of Capital Projects' operations.

What We Found?

- The Traffic and Drainage Divisions are managed by a single operations manager who reports to the Deputy Director of Operations.

- Differently, the Streets Division has two levels of upper management, a Streets Operations Manager and a Streets & Traffic Superintendent.
    - The two upper management positions of the Streets Division have similar competency requirements.
    - The Streets & Traffic Superintendent does not provide managerial support or supervision for the Traffic Division.

Why Does It Matter?

Managerial redundancy typically increases the complexity of high-level decision making, decreasing the efficiency of the division. Similarly, the City may be paying more than necessary in salary to provide managerial support and supervision for the Streets Division.

As of May 2019, the employee currently holding the Streets & Traffic Superintendent position has elected to retire from the City. Streets Division management has stated that they do not intend to fill this position, which would functionally alleviate the redundancy identified.

Recommendations:

12. Revise the Streets Operations Manager and Streets & Traffic Superintendent job descriptions to more accurately reflect current job responsibilities. Consideration should be given to the job responsibilities assigned to the Construction Projects Manager and Field Services Supervisors so as not to create managerial redundancy. If total job responsibilities do not warrant two positions, they should be combined into one.

    Public Works Comments: *Duplicate level of Supervision was eliminated with the retirement of the Streets Superintendent.*

Appendix A: Management Response Summary

The following summarizes the recommendations issued throughout this report. Based on management's request, our Office has designated recommendations 1, 2, and 3 to be high priority. The auditors found that staff and the Division was receptive and willing to make improvements to controls where needed. Management has provided their response to each recommendation.

1	*Develop a standardized process for recording and approving design adjustments to in-house street rehabilitation projects.*	**Concur**	Expected Completion: 1st Quarter 2020
Public Works Comments: Staff will implement process controls for deviation from recommendations. This will include written documentation escalated and signed by management to approve the deviation. SOPs (standard operating procedures) will be created and all employees will be trained on the process.			Responsibility: Daniel Kremer
2	*Develop a record retention system to store inspection reports and geotechnical reports for each street rehabilitation project according to the Texas State Library and Archives Commission's regulations.*	**Concur**	Expected Completion: 1st Quarter 2020
Public Works Comments: Staff will establish SOPs (standard operating procedures) for record retention. Cartegraph, our internal work order system, can be structured so that all pertinent documents to the specific job are stored in the system and reports can be run to retrieve the data.			Responsibility: Daniel Kremer
3	*Require Streets Field Services Supervisors to submit periodic inspection reports as part of the quality acceptance decision-making process for street rehabilitation projects.*	**Concur**	Expected Completion: 1st Quarter 2020
Public Works Comments: Standardized inspection documentation will be created and implemented. These documents will be specific to the work being performed, (mill and overlay, micro seal, reconstruction, etc.), archived in the Cartegraph system, and tied to the work order. SOPs (standard operating procedures) will be created and all employees will be trained.			Responsibility: Daniel Kremer
4	*Consider including street connectors in bond program proposals in the future to better estimate costs and provide greater transparency to residents.*	**Concur**	Expected Completion: Fall 2019
Public Works Comments: Staff will recommend implementing this practice to the Bond committee. The ultimate decision is left up to the committee. Staff will follow Bond Committee and City Council direction.			Responsibility: Daniel Kremer
5	*Develop a process to consistently document the street segments included in each project.*	**Concur**	Expected Completion: 1st Quarter 2020
Public Works Comments: Staff will restructure the intake portion of the workorder system to more efficiently tie street segments together on larger jobs. SOPs (standard			Responsibility: Daniel Kremer

operating procedures) will be created and all employees will be trained in the new process.

6	*Finance should consider accounting for each general obligation bond series in a separate fund.*	**Partially Concur**	Expected Completion: N/A
Finance Comments: The consolidation of bond funds was implemented in 2014 to streamline the tracking of project costs and expenses of bond proceeds. Among other benefits, consolidation limits the number of funds necessary to account for project construction costs. The City's Bond Counsel approved of consolidation, and the City's annual external audits have approved capital projects expenditures related to bond related projects. Following the approval of a new bond program, staff will consider all options for bond fund accounting.			Responsibility: Finance
7	*Include up-to-date installed date information in the Cartegraph system.*	**Partially Concur**	Expected Completion: Ongoing
Public Works Comments: Staff will work with IT to update the install date for older infrastructure pulling information from GIS. While the install date is important it is not vital. With regular pavement studies the street condition is evaluated at that time and a maintenance plan is established on the current condition.			Responsibility: Daniel Kremer
8	*Consider adjusting the amount of OCI points added to a street segment for overlays.*	**Partially Concur**	Expected Completion: 2nd Quarter 2020
Public Works Comments: Staff will discuss the recommendation with the Pavement survey contractor. All performance curves and OCI adjustments after completion of work is a base line set by pavement analysis company. This company will be conducting another survey in the next fiscal year and will reevaluate at that time.			Responsibility: Daniel Kremer
9	*Provide training for crew leaders entering work order information into the Cartegraph system.*	**Concur**	Expected Completion: 1st Quarter 2020
Public Works Comments: Staff will create SOPs (standard operating procedures) and all employees will be trained on the process of work order entry.			Responsibility: Daniel Kremer
10	*Check the Texas State Comptroller's website for related historically underutilized businesses when obtaining quotes for purchases between $3,000 and $50,000.*	**Concur**	Expected Completion: 6/7/2019
Public Works Comments: Staff has been trained on the correct process for properly quoting jobs. Continued education will continue as other Purchasing procedures are updated.			Responsibility: Daniel Kremer
11	*Contract for the rental of signs and barricades to mark road construction sites.*	**Concur**	Expected Completion: 6/18/2019

Public Works Comments: Contract was approved by City Council June 18th.

Responsibility: Daniel Kremer

12	*Revise the Streets Operations Manager and Streets & Traffic Superintendent job descriptions to more accurately reflect current job responsibilities.*	**Concur**	Expected Completion: 6/28/2019

Public Works Comments: Duplicate level of Supervision was eliminated with the retirement of the Streets Superintendent.

Responsibility: Daniel Kremer

Appendix B: Remaining Bond Program Street Segments

The street segments listed below were identified for rehabilitation as part of the 2012 and 2014 bond program, however, we found no evidence that the rehabilitation process had begun. They are included here as reference for the Streets Division.

Table 9: Remaining Street Segments

Bond Year	Seg ID	Street	Route Back	Route Ahead	Lane Miles
2012	116-3	Bowling Green St	Georgetown Dr	Vanderbilt St	0.6807
	116-4	Bowling Green St	Vanderbilt St	Auburn Dr	0.3659
	407-7	Highland Park Rd	Willowcrest Loop	Willowcrest Loop	0.2155
	666	Oakhurst St	Bentoaks Dr	Oakhurst St	0.1355
	829	Sheraton Pl	Sheraton Rd	Buckingham Dr	0.2604
	959	Williams Ln	Buckingham Dr	Royal Acres Dr	0.1736

The Streets Division has developed and has generally implemented processes to improve roadway construction quality assurance.

In addition, the Division has improved its usage of the work order system through training and correction of some system update errors. Finally, all procurement concerns have been corrected.

Audit of Roadway Quality Management Audit

Follow-Up Review

Audit Team

City Auditor
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Table of Contents

Follow-Up at a Glance

Why we did this Follow-Up:

This report is intended to provide information on what changes have been made in response to the Audit of Roadway Quality Management issued in October 2019. The original audit evaluated the City's ability to safeguard and improve the City's roadway network. This follow-up review was included on the City's fiscal year 2020-21 Annual Audit Plan as approved by the City Council.

What we Found:

The Streets Division has developed and has generally implemented processes for approving street rehabilitation design adjustments, inspecting in-house roadway rehabilitations, and retaining quality assurance documentation. In addition, the Division has generally improved its usage of the work order system through training and correction of some system update errors. Finally, all procurement and Division structure issues identified in the original audit have been corrected. The status of each recommendation is summarized below:

Recommendation	Mgmt. Response	Status
1. Develop standardized process for recording/approving street rehabilitation design adjustments.	Concur	In Progress
2. Develop a record retention system for inspections & geotechnical reports.	Concur	Implemented
3. Require Streets Field Supervisors to submit periodic inspection reports.	Concur	In Progress
4. Consider including street connectors in bond program proposals in the future.	Concur	Implemented
5. Develop a process to document street segments in each project.	Concur	Implemented
6. Consider accounting for each GO bond series in a separate fund.	Partially Concur	Implemented
7. Include up-to-date installed date info in Cartegraph.	Partially Concur	Implemented
8. Consider adjusting the amount of OCI points added for street overlays.	Partially Concur	Implemented
9. Provide training for crew leaders entering WO info into Cartegraph.	Concur	Implemented
10. Check for HUBs when obtaining applicable quotes.	Concur	Implemented
11. Contract for the rental of signs and barricades.	Concur	Implemented
12. Revise the Streets Operations Manager & Streets & Traffic Superintendent job descriptions.	Concur	Implemented

Audit report translations may be requested by emailing InternalAudit@CityofDenton.com.

Introduction

The Internal Audit Department is responsible for providing: (a) an independent appraisal[1] of City operations to ensure policies and procedures are in place and complied with, inclusive of purchasing and contracting; (b) information that is accurate and reliable; (c) assurance that assets are properly recorded and safeguarded; (d) assurance that risks are identified and minimized; and (e) assurance that resources are used economically and efficiently and that the City's objectives are being achieved.

The Internal Audit Department has completed a follow-up review of the Audit of Roadway Quality Management issued in October 2019. We conducted this performance audit 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.

Management Responsibility

City management is responsible for ensuring that resources are managed properly and used in compliance with laws and regulations; programs are achieving their objectives; and services are being provided efficiently, effectively, and economically.

Audit Objectives, Scope, and Methodology

This report is intended to provide a progress update on recommendations from the Audit of Roadway Quality Management (October 2019), which evaluated the City's ability to safeguard and improve its roadway network.

Audit fieldwork was conducted during September 2021. The scope of review varied depending on the procedure being performed. The following list summarizes major procedures performed during this time:

➢ Reviewed documentation from the original audit to develop criteria including industry standards, best practices, policies, procedures, and the issued report;

➢ Analyzed Streets Division work orders completed since October 2019 to determine if they contained complete information;

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[1] The City of Denton's Internal Audit Department is considered structurally independent as defined by generally accepted government auditing standard 3.56.

➢ Evaluated 15 rehabilitation work orders[2] to determine if quality assurance documentation was appropriately retained;

➢ Examined Streets Division purchase orders issued during fiscal year 2019-20 as well as streets bundle bid plans finalized since October 2019 and the signs and barricades rental contract executed in June 2019;

➢ Interviewed City staff from the Finance Department, Public Works Department, and Engineering & Capital Improvement Projects Department; and

➢ Reviewed select Streets Division job descriptions as well as the City's fiscal year 2020-21 general pay plan.

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[2] Rehabilitation work orders include roadway reconstructions and roadway overlays; see Appendix A for additional information on the types of roadway maintenance and improvements performed by the Streets Division.

Recommendation Status Update

This report summarizes the Audit of Roadway Quality Management's recommendations, management responses, and the Internal Audit Department's follow-up findings, which describe to what extent City management has implemented Internal Audit's recommendations since publication of the original report in October 2019.

Roadway Rehabilitation Quality Cannot Always be Assured

1. **Develop a standardized process for recording and approving design adjustments to in-house street rehabilitation projects.**

   Management Response: Concur
   Staff will implement process controls for deviation from recommendations. This will include written documentation escalated and signed by management to approve the deviation. SOPs (standard operating procedures) will be created and all employees will be trained on the process.

   Audit Follow-Up Finding: In Progress
   The Streets Division has developed a change order form that they intend to use to document requests and approvals of changes to street rehabilitation projects; however, the Division has not had an opportunity to use this form since its creation during the summer of 2021. A standard operating procedure was implemented in October 2021 to formalize this change order process.

2. **Develop a record retention system to store inspection reports and geotechnical reports for each street rehabilitation project according to the Texas State Library and Archives Commission's regulations.**

   Management Response: Concur
   Staff will establish SOPs (standard operating procedures) for record retention. Cartegraph, our internal work order system, can be structured so that all pertinent documents to the specific job are stored in the system and reports can be run to retrieve the data.

   Audit Follow-Up Finding: Implemented
   The Streets Division adopted a standard file folder format for their rehabilitation projects in 2019. Based on a review of eight reconstruction projects completed since October 2019, the file folders for five of the projects appear to align with the adopted format. In addition, six of these projects had appropriate subgrade testing documentation that was retained and could be found. While two projects did not have retained subgrade testing documentation, these projects were completed in 2019.

Projects completed since then generally appear to have adequately retained subgrade testing documentation.

3. **Require Streets Field Supervisors to submit periodic inspection reports as part of the quality acceptance decision-making process for street rehabilitation projects.**

   Management Response: Concur
   Standardized inspection documentation will be created and implemented. These documents will be specific to the work being performed, (mill and overlay, micro seal, reconstruction, etc.), archived in the Cartegraph system, and tied to the work order. SOPs (standard operating procedures) will be created and all employees will be trained.

   Audit Follow-Up Finding: In Progress
   Based on discussions with staff from the Streets and Public Works Inspections Divisions, Streets has worked with Public Work Inspections to design an inspections process for Streets in-house rehabilitation projects.

   Under this process, the Streets Division would request an inspection through the City's construction management software. The inspection would then be performed by Public Works Inspections staff using standardized inspection checklists that are also used for the City's capital improvement projects. The results of these inspections would then be retained in the construction management software.

   While this process appears to be designed effectively, Public Works Inspections has not begun performing inspections for Streets' in-house projects. These inspections are scheduled to begin in early fiscal year 2021-22.

Changes to Street GO Bond Administration Could Further Enhance Transparency

4. **Consider including street connectors[3] in bond program proposals in the future to better estimate costs and provide greater transparency to residents.**

   Management Response: Concur

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[3] Street connectors are those street segments near or in between street segments with a low overall condition index – or OCI – score that have higher OCIs that would typically indicate the street segment does not need to be rehabilitated.

Staff will recommend implementing this practice to the Bond committee. The ultimate decision is left up to the committee. Staff will follow Bond Committee and City Council direction.

Audit Follow-Up Finding: Implemented
After completion of the original audit, the City held an election in November 2019 for citizens to vote on the issuance of new general obligation bonds.[4] Some of this funding was intended to be used to rehabilitate street segments with low overall condition index – or OCI – scores.[5] Once the issuance of these general obligation bonds was approved, this set of street segments was known as the 2019 Street Bond Program.

According to the Streets Division, they worked with the City's utilities to identify street segments that would need to be replaced soon due to utility work that were near low OCI segments identified as part of the 2019 Street Bond Program. The City has since awarded two solicitations for rehabilitation of street bundles – or several street segments in the same area – to begin completing construction on the 2019 Bond Program.

Based on review of the construction plans included in these solicitations, both street bundles included connector street segments as identified by the Streets Division.

5. **Develop a process to consistently document the street segments included in each project.**

    Management Response: Concur
    Staff will restructure the intake portion of the workorder system to more efficiently tie street segments together on larger jobs. SOPs (standard operating procedures) will be created and all employees will be trained in the new process.

    Audit Follow-Up Finding: Implemented
    The Streets Division has identified a way to link different work orders together under one project in their work order system and are currently in the process of completing the first project using this methodology. Once this project is complete, they plan to formalize this process in a standard operating procedure and use it for projects going forward.

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[4] General obligation bonds are a common type of municipal bond that is secured by a local government's pledge to use legally available resources, including tax revenues, to repay bond holders.
[5] The overall condition index score is an indicator of a streets condition based on visible pavement distresses, road roughness, and structural integrity.

6. **Finance should consider accounting for each general obligation bond series in a separate fund.**

Management Response: Partially Concur
The consolidation of bond funds was implemented in 2014 to streamline the tracking of project costs and expenses of bond proceeds. Among other benefits, consolidation limits the number of funds necessary to account for project construction costs. The City's Bond Counsel approved of consolidation, and the City's annual external audits have approved capital project expenditures related to bond related projects.

Following the approval of a new bond program, staff will consider all options for bond fund accounting.

Audit Follow-Up Finding: Implemented
The City is currently accounting for 2012 and 2014 general obligation bond revenues in one fund as identified in the original audit; however, general obligation bond revenues associated with the 2019 Bond Program are being accounted for in a separate fund. Table 1 summarizes allocated general obligation bond program revenues for street reconstruction.

Table 1: Summary of Street Reconstruction GO Bond Funding (Millions)

Bond Series	Allocated Bond Amount	Revised Project Cost	Spent Amount
2012	$20.0	$22.8	$25.9
2014	$24.0	$32.8	$28.9
2019	$70.0	$70.0	$5.2
All:	$114.0	$125.6	$60.0

Data Issues Impede Pavement Monitoring Effectiveness

7. **Include up-to-date installed date[6] information in the Cartegraph system.**

Management Response: Partially Concur
Staff will work with IT to update the installed date for older infrastructure pulling information from GIS. While the install date is important it is not vital. With regular pavement studies the street condition is evaluated at that time and a maintenance plan is established on the current condition.

Audit Follow-Up Finding: Implemented

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[6] The install date is when the road was constructed and put into service.

As part of the City's periodic OCI update process, the Streets Division asked the consultant to estimate the install date for all of the City's roadways. This estimated information will be entered into the City's work order system along with the updated OCI. Similarly, the install date for all newly constructed street segments is recorded in the work orders system.

In addition, the Streets Division appears to have corrected an issue in the work order system that now allows a street segment's replace date to be updated when a reconstruction work order is completed. Based on review of eight reconstruct projects completed since October 2019, all had a reasonable replacement date.

8. **Consider adjusting the amount of OCI points added to a street segment for overlays.**

   Management Response: Partially Concur
   Staff will discuss the recommendation with the Pavement survey contractor. All performance curves and OCI adjustments are completion of work is a base line set by pavement analysis company. This company will be conducting another survey in the next fiscal year and will reevaluate at that time.

   Audit Follow-Up Finding: Implemented
   The Streets Division has been working with a consultant to inspect all City roadways to update each street segment's OCI. This reinspection process generally occurs every five years to ensure that the City is effectively monitoring the condition of its roadway network.

   As part of the current reinspection process, Streets plans to discuss the amount of OCI points added to a street segment for overlays, however, a decision has not yet been made. While the process for updating OCI after an overlay has not necessarily been changed, periodically reevaluating this with the consultant adequately addresses the identified risk.

9. **Provide training for crew leaders entering work order information into the Cartegraph system.**

   Management Response: Concur
   Staff will create SOPs (standard operating procedures) and all employees will be trained on the process of work order entry.

   Audit Follow-Up Finding: Implemented
   The original audit found that there were some consistency issues in the information that was being entered into the Streets Division's work order system. Specifically, there were:
   - Redundancy issues in the work order activity codes;

➢ Missing construction start dates from completed work orders; and
➢ Missing cost information from completed work orders.

According to Streets Division staff, Streets crews were trained in June 2020 on how to create and update work orders. While trainings were temporarily halted due to the COVID-19 Pandemic, they have begun again as of August 2021. The Division has aslo developed a list of acceptable work order activities in an effort to reduce redundancy.[7]

Based on an analysis of work orders, between fiscal year 2019-20 and fiscal year 2020-21, the percentage of work orders used by the Street Division that were on the acceptable activities list increased from 87.5 percent to 91.2 percent, indicating that consistency has increased. Similarly, the percentage of work orders missing start dates and cost information has significantly decreased as shown in Table 2.

Table 2: Work Order Information Completion Comparison

	FY2019-20	FY2020-21
Total Work Orders	2,049	2,911
Percent Acceptable Activity	87.5%	91.2%
Percent Missing Start Date	8.0%	0.9%
Percent Missing Cost Info	9.0%	1.8%

While the June 2020 training appears to have corrected most of the data issues, Streets should continue to ensure that field crew staff receive training on work order information entry completion to ensure these data issues do not return. According to Division management, they acquired a training program from the work order system company, which will be used to help train administrative and field staff in the future.

Potential Cost Savings May Exist in the Purchasing Process

10. **Check the Texas State Comptroller's website for related historically underutilized businesses when obtaining quotes for purchases between $3,000 and $50,000.**

    Management Response: Concur
    Staff has been trained on the correct process for properly quoting jobs. Continued education will continue as other Purchasing procedures are updated.

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[7] Work orders not on the acceptable activities list are not necessarily inappropriate for Streets crews to perform, but are similar to or part of activities on the acceptable list.

Audit Follow-Up Finding: Implemented
During fiscal year 2019-20, the Streets Division issued a total of $8.2 million in purchase orders. About $8.1 million was covered under a contract. The remaining $121,411 were spent as shown in Table 3.

Table 3: Non-Contracted Streets Improvement Fund Purchases

Commodity	Compliant?	Total Purchases
Concrete Road Construction	Quotes Needed	$36,428
Asphalt	Yes	$30,000
Guard Rails	Yes	$30,000
Backhoe Rental	Yes	$12,328
Skid Steer Loader Rental	Yes	$10,545
Professional Service	Exempt	$2,110
	All:	$121,411

Based on review of the available purchasing documentation, all but one of these purchases appear to have been procured in accordance with Texas procurement regulations.

That being said, this purchase for concrete road construction was procured with a vendor that had a contract for similar work; however, it was not clear if this purchase was under this contract based on the documentation available in the City's financial system.

11. **Contract for the rental of signs and barricades to mark road construction sites.**

     Management Response: Concur
     Contract was approved by City Council June 18th.

     Audit Follow-Up Finding: Implemented
     The City entered into a contract for the rental of signs and barricades in June 2019. The City has spent $314,266 under this contract to date.

Current Management Structure Indicates Redundancy

12. **Revise the Streets Operations Manager and Streets & Traffic Superintendent job descriptions to more accurately reflect current job responsibilities.**

     Management Response: Concur
     Duplicate level of supervision was eliminated with the retirement of the Streets Superintendent.

     Audit Follow-Up Finding: Implemented

The Streets & Traffic Superintendent position has been eliminated and is no longer on the City's pay plan. The Streets Operations Manager job description adequately covers the responsibilities of both of the previous positions' job descriptions.
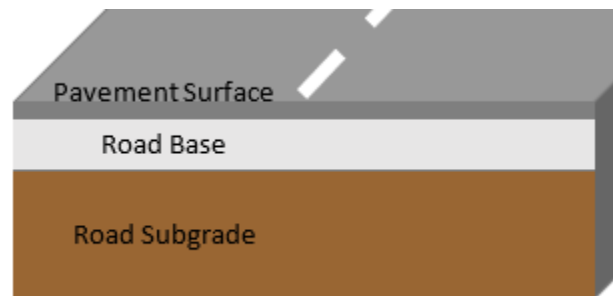
Appendix A: Roadway Maintenance & Improvements Terminology

No matter how well constructed, a roadway will deteriorate over time due to the effects of traffic loads and the environment. Roadway maintenance and improvements are used to slow down or reset this deterioration process. Generally, there are three different classifications of roadway maintenance and improvements that are further described below. Each of these maintenance and improvement techniques are useful at different points in the pavement's life cycle and typically cost decreasing amounts of money from rehabilitative to corrective to preventative techniques.

Rehabilitative improvements repair portions of an existing pavement to reset the deterioration process. The City uses asphalt overlays and concrete panel replacements to rehabilitate the pavement surface of a road. An overlay involves milling away the existing pavement surface and then laying new asphalt to repave the roadway. Similarly, a panel replacement removes the existing concrete pavement and replaces it with a new panel.

The reconstruction of a roadway involves the stabilizing and compacting of the naturally occurring material, called the subgrade. Additionally, a base layer, typically made of compacted aggregate material, may be added on top of the subgrade to further improve the structure's integrity. Finally, the pavement surface is lain to protect these underlying pavement layers (see Picture 1).

Picture 1: Simplified Roadway Cross Sections

Corrective maintenance helps to slow the rate of deterioration by repairing localized failures of the underlying layers. Specifically, the City repairs potholes, utility cuts, and base failures through the use of patching and level ups. Patching and level ups involve replacing an area of the pavement surface with new material after repairing an underlying deficiency. While patching is a maintenance technique, it weakens the pavement's surface and cannot fully replicate the integrity of the original road's structure. These weaknesses can only

be corrected through rehabilitative improvements such as milling and overlay techniques.

<u>Preventative maintenance and improvements</u> help to slow the rate of deterioration by addressing minor deficiencies on the pavement surface caused by the passage of time. Specifically, the City utilizes crack sealing and micro sealing techniques to prolong the useful life of a pavement. Crack sealing is the process of individually filling cracks along the pavements surface to prevent the entry of water, weeds, rocks, etc.; a similar technique, called joint sealing, may be used for concrete pavements. These techniques help to prevent the deterioration of the roads underlying layers. Micro sealing is the process of adding a thin layer of asphalt to an existing pavement surface, extending the useful life of that surface; this technique is also considered a roadway improvement.

City of Denton

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Legislation Text

File #: IAAC24-010, **Version:** 1

AGENDA CAPTION

Receive a report, hold a discussion, and take necessary action regarding the completion and closure of Audit Project 007 - Accounts Payable.

City of Denton

AGENDA INFORMATION SHEET

DEPARTMENT: **City Auditor's Office**

CITY AUDITOR: **Madison Rorschach**

DATE: **April 29, 2024**

SUBJECT
Receive a report, hold a discussion, and take necessary action regarding the completion and closure of Audit Project 007 – Accounts Payable.

BACKGROUND
In accordance with the City of Denton Ordinance 21-2035, the Internal Audit Advisory Committee is responsible for providing oversight of the internal audit function, including monitoring follow-up on reported findings to assure corrective action is taken by management.

DISCUSSION
An audit project of the City's accounts payable processes was originally conducted and reported to the City Council in October 2019. This audit identified some risks related to the documentation of accounts payable procedures, information system controls, the potential for duplicate payments, and approval requirements for small purchases.

Since the issuance of this audit, several significant improvements have been made to the City's procurement process including:

- Implementation of a cash disbursements policy to provide additional guidance to Accounts Payable and department staff including formalizing standard for receiving documentation and improving controls over check processing;

- Removal of Accounts Payable Representatives ability to enter procurement requisitions and receipts;

- Implementation of a process to identify if payments made on a procurement card have also been paid by Accounts Payable; and

- Requiring payments issued by check valued under $5,000 and about $320,000 of office supply purchases to be approved by a supervisor.

Internal Audit generally evaluated these process improvements as part of the March 2021 and September 2023 follow-up reviews and believes that these improvements adequately address the recommendations issued as part of the original Audit of Accounts Payable with the exception of Recommendation 10 regarding encouraging the use of electronic payments, which appears to be in progress. Staff plans to reevaluate this operational efficiency risk as part of the upcoming vendor management audit project.

RECOMMENDATION

Staff recommends approval of the attached Audit Project Completion Form and final closure of Audit Project 007 – Accounts Payable. These processes will continue to be considered for review annually as part of the Annual Internal Audit Plan development process.

PRIOR ACTION/REVIEW (Council, Boards, Commissions)

Aug. 20, 2019: Audit/Finance Committee recommended forwarding the Audit to City Council

Oct. 8, 2019:   Audit of Accounts Payable presented; Council directed Project 007 be closed till a follow-up review was conducted

Mar. 16, 2021: Audit of Accounts Payable: Follow-Up Review presented; Council directed Project 007 be closed till an additional follow-up review was conducted

Sep. 26, 2023: Audit of Accounts Payable: Second Follow-Up Review presented; Council agreed with Staff's direction to consider Project 007 complete

EXHIBITS

1. Agenda Information Sheet
2. Audit Project Completion Form – 007 Accounts Payable
3. Audit of Accounts Payable
4. Audit of Accounts Payable: Follow-Up Review
5. Audit of Accounts Payable: Second Follow-Up Review

Respectfully submitted:
Madison Rorschach, 940-349-7228
City Auditor

Audit Project Completion Form

Project Title: Accounts Payable   Project Number: 007

Table 1: Project Timeline

Deliverable	Responsible Staff	Audit Plan FY	Date Issued	Months to Complete	Hours to Complete
Audit Report	Madison Rorschach Umesh Dalal	FY2018-19	10/08/2019	8.00	NA
Follow-Up Report	Madison Rorschach Amber Jackson	FY2020-21	10/12/2021	1.50	NA
Second Follow-Up Report	Madison Rorschach Amber Jackson	FY2022-23	09/26/2023	NA	31.25
			Total:	**9.5**	**31.25**

Concurrent Rate: 100%   Implementation Rate: 92%

Table 2: Project Recommendation Summary

Recommendation	Mgmt. Response	Status
1. Formalize an AP policies & procedures manual.	Concur	Implemented
2. Ensure AP & Purchasing staff don't have incompatible system access.	Concur	Implemented
3. Include a standard invoice numbering guideline in the policies & procedures manual.	Concur	Implemented
4. Consider developing a procedure to verify invoices weren't paid via p-card.	Concur	Implemented
5. Establish a process to ensure the City isn't paying exempt taxes.	Concur	Implemented
6. Require employees to enter adequate receiving documentation for all goods & services.	Concur	Implemented
7. Consider requiring employees who physically receive goods & services to enter receiving documentation.	Concur	Implemented
8. Require check requisitions under $5,000 to be approved.	Concur	Implemented
9. Restrict physical collection of checks.	Concur	Implemented
10. Encourage use of electronic payments.	Concur	In Progress
11. Ensure Staples purchases are approved & received.	Concur	Implemented
12. Annually review Staples users to verify access.	Concur	Implemented
13. Consider changing Staples billing practices to improve efficiency in the AP Division	Partially Concur	Implemented

Based on the project timeline and recommendation summary listed previously, the City Auditor recommends this project be closed and considered formally complete:

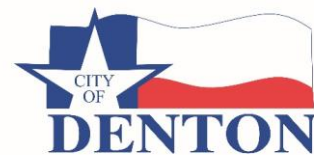City Auditor: _Madison Rorschach_   Date: 10/13/2023

AUDIT OF ACCOUNTS

PAYABLE

ABSTRACT

Controls over $525 million of payments were generally adequate. This audit recommends some improvements to documentation and supervisory review that will increase assurance that all payments made are appropriate.

City Auditor's Office

Table of Contents

Executive Summary

Honorable Mayor and City Council Members,

We have completed a scheduled audit of Accounts Payable function. During fiscal year 2018, the City of Denton was invoiced for about $525 million from various suppliers and entities. The objective of this audit was to verify if the City has appropriately established controls over accounts payable in order to properly record and safeguard the spending of municipal funds.

Overall, the controls over disbursements made by Accounts Payable were adequate and the audit did not identify any abuses of the system. However, some improvement in controls are necessary as described below:

- Currently, Accounts Payable does not have a formal, written policy and procedures manual. A formalized policies and procedures manual helps ensure consistency in operations. In addition, it can act as a training tool during transition due to turnover. The current Materials Management and Payment Procedures Manual includes some written procedures, but they are not adequate for the Accounts Payable operation.
- In today's heavily automated business environment, proper controls are necessary to ensure that employees can perform only authorized functions. Allowing employees to perform incompatible functions could lead to misuse. During this audit, we found that several employees had system access privileges in excess of necessity to perform their function. Due to the magnitude of resources processed through the account payable and purchasing functions, strengthening these controls is critical.
- One of the accounts payable function's important controls is to ensure that the City only pays when:
    - The City has received the ordered quantity and appropriate quality of goods or services; and
    - The vendor has correctly billed for the quantity of goods or services at the agreed upon price.

    Generally, the above assurance is obtained by matching a purchase order, receiving document, and vendor bill before making a payment. This is a standard control mechanism used universally. We found that this control is not functioning because the City does not have an adequate process for verifying the receipt of goods or services. The City's practice of allowing employees to pick up checks for vendors compounds this risk.
- The City is spending approximately $700,000 on the office supplies contract. Better controls are desired in this area. Currently, the employees can purchase items from the vendors website without the need for any approval. The vendors' website offers several items that can be used for personal consumption. Presently, the employee ordering the product may receive them from the vendor without anyone knowing. This situation can lead to abuses.

This report recommends the implementation of control procedures. Management has concurred with 12 of 13 recommendations and partially concurred with the last. Management's response is attached to this report in Appendix A. We appreciate staff's cooperation during the audit. Please contact the City Auditor if you have any questions.

Sincerely,
Umesh Dalal, City Auditor

Introduction

The City Internal Auditor is responsible for providing: (a) an independent appraisal of City operations to ensure policies and procedures are in place and complied with, inclusive of purchasing and contracting; (b) information that is accurate and reliable; (c) assurance that assets are properly recorded and safeguarded; (d) assurance that risks are identified and minimized; and (e) assurance that resources are used economically and efficiently and that the City's objectives are being achieved.

The City Auditor's Office has completed a performance audit of the accounts payable process. We conducted this performance audit in accordance with generally accepted government auditing standards with the exception of standard 4.18 regarding documentation of audit staff's continuing professional education.[1] 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.

Management Responsibility

City management is responsible for ensuring that resources are managed properly and used in compliance with laws and regulations; programs are achieving their objectives; and services are being provided efficiently, effectively, and economically.

Audit Objectives, Scope, and Methodology

This report is intended to provide assurance that the City has appropriately established controls over accounts payable in order to properly record and safeguard the spending of municipal funds.

Audit fieldwork was conducted during May and June of 2019. The scope of review varied depending on the procedure being performed. The following list summarizes major procedures performed during this time:

- Reviewed documentation to develop criteria including industry standards, best practices, policies, and procedures;

- Developed a process narrative via staff interviews to identify current control activities, which was certified by the Controller, Assistant Controller, and Accounts Payable Supervisor;

- Examined a sample[2] of 95 fiscal year 2018 payments to ensure that they were properly approved and verified;

- Inspected a selection of 27 payment vouchers to calculate exempt tax payments;

- Reviewed a targeted selection of 30 payment vouchers posted during fiscal year 2018 to ensure they were properly approved and verified;

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[1] This report was amended on February 15, 2022 to disclose this exception, the details of which were communicated to the City Council in a Staff Report publicly issued on February 11, 2022.
[2] This sample size provides with 95% confidence that the true sample mean is within ±10% of the sample estimate.

- Examined Staples Advantage expenses for the month of April 2019 and interviewed the City's Staples Strategic Account Manager; and

- Inspected key user access reports for the City's financial system.

Glossary of Terms

The following glossary of terms has been provided as reference material:

ACH Payments are electronic payments made through the Automated Clearing House network.

JD Edwards is the City's financial system and is utilized to track the City's financial transactions including purchases.

Non-Purchase Order transactions typically involve the payment of non-commodity services such as a telephone or energy bill payment. These payments do not have a standard initiation, approval, or receiving process.

Payment Disbursement process involves the processing and dispersal of checks and ACH payments.

Payment Obligations or the obligation to pay is a contractual obligation of an organization to pay an amount owed to a supplier.

Payment Requisitions are initiated by a department employee and approved by a supervisor at certain monetary levels – above $5,000 for checks and above $25,000 for ACH payments. AP staff require documentation of the receipt of goods or services typically via an invoice.

Positive Pay is an automated fraud detection tool offered by most banks; simply it matches the account number, check number, and dollar amount of each check presented for payment against a list of checks previously authorized and issued by the company.

Purchase Orders are initiated by a department employee in JDE via a requisition order (OR). This OR is then approved by an appropriate departmental supervisor and the Procurement Division before being converted into a purchase order (OP). An employee must then receive on this order in JDE before being vouched by AP.

Refunds for utility customer service or the municipal court are typically initiated by a department employee and approved via reconciliation by a supervisor. These payments are automatically interfaced with JDE before being vouched by AP.

Reimbursements & Advancements are initiated by a department employee and approved by a supervisor at all expenditure levels. These transactions typically involve the reimbursement of or payment advance to employees for travel and training expenses. Staff must submit receipts and other evidence of received goods or services in order to receive these payments.

Three-Way Matching is an obligation to pay verification procedure that ensures the items ordered on a purchase order correspond to those received on a receiving document to those billed by the supplier on the invoice. In the City of Denton, this verification process is done automatically in the JD Edwards system.

**Vouchers** are an internal document typically created by AP staff describing and authorizing the payment of a liability to a supplier.

Wire Transfers are initiated by a department employee, approved by a supervisor, and reviewed by an appropriate Finance manager. These transactions typically involve the payment of employee benefits and are physically vouched by Treasury staff before being posted by AP.

What Works Well?

During fiscal year 2018, the City of Denton was invoiced for about $525 million from various suppliers and entities.[3] The City has centralized the responsibility for processing these payments within the Accounts Payable (AP) Division of the Finance Department; this process is summarized in Figure 1 below. The City's Materials Management and Payment Procedures Manual is available to guide the supplier procurement and payment process.

Figure 1: Accounts Payable Payment Processing Steps
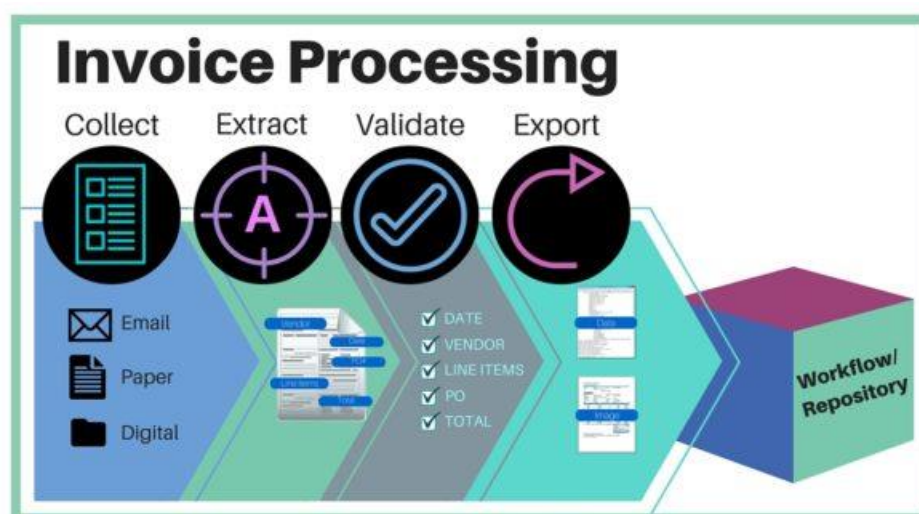
Obligation to Pay Procedures Ensure Purchasing Policy Compliance

Most simply, it is the function of an accounts payable division to verify an organization's obligation to pay suppliers and other entities that are owed money. In the City of Denton, this obligation to pay is verified in three ways: 1) automated three-way matching, 2) manual review by the Treasury Division, and 3) manual review by the Accounts Payable Division. Our findings are summarized in Table 1. The auditors found the following:

Table 1: Obligation to Pay Verification Summary by Vouchers (FY 2018)

Verification Procedure	Est. Amount (Millions)	Est. Vouchers	Policy Compliance *
Three-Way Match	$222.9	8,018	Adequate
Manual Treasury	$311.1	445	Adequate
Manual AP	$17.5	5,643	Adequate
Refunds	*$0.4*	*2,376*	*Adequate*
Payment Req.	*$14.8*	*1,782*	*Adequate*
Reimb. & Adv.	*$1.8*	*1,118*	*Adequate*
Non-PO	*$0.5*	*297*	*N/A*
All:	$551.5	14,106	N/A

*Indicates level of compliance assurance with purchasing policies but does not indicate control effectiveness

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[3] This amount does not include purchases made via procurement card program, which is administered by the Procurement & Compliance Department, or payroll payments made to employees, which are processed by the Payroll Division of Finance.

Three-Way Match

- Based on our sample, 57% of payment vouchers were verified via a three-way match procedure in accordance with the Purchasing Manual. These vouchers amount to about 40% of all payments certified, or about $222.9 million.

- The JD Edwards system requires departmental staff to enter a receiver on a purchase order created by the Purchasing Division as required by the Materials Management and Payment Procedures Manual.

  - o AP staff then verify that the invoice and receiver match, that the invoice is accurate, and that the vendor address and name match before posting the voucher.

Manual Treasury Review

- Based on our sample, 3% of payment vouchers were verified manually by the Treasury Division as part of wire transfer procedures. These vouchers total to about 56% of all payments certified, or about $311.1 million.

- Treasury staff have developed a standardized wire transfer request form that requires appropriate supervisor approval based on transaction value.

  - o Current procedures require Controller approval for transactions less than $50,000, Assistant Finance Director approval between $50,000 and $100,000, and Finance Director approval above $100,000.

  - o Payment procedures require that all wire transfers greater than $25,000 be approved by the Director of Finance and all transfers less than that be approved by the Controller. While current procedures do not comply with purchasing policy, these controls are adequate; policies should be updated to reflect current procedures.

Manual AP Review

- Based on our sample, 40% of payment vouchers were verified manually by Accounts Payable. These vouchers total to about 3% of all payments certified, or about $17.5 million.

  - o These vouchers included: refunds, payment requisitions, reimbursements & advances to employees, and non-purchase order invoices and statements.

- Refunds (42% of manual AP vouchers) are submitted weekly to Accounts Payable via a system interface with JD Edwards.

  - o Customer Service identifies refunds on closed customer accounts weekly; for active accounts, customers may request a refund once their credit is greater than two average monthly bills. Once refunds are identified, a Customer Service supervisor verifies their accuracy before forwarding the requests to Accounts Payable.

  - o Municipal Court refunds are identified weekly based on Docket Clerk documentation. A Municipal Court supervisor verifies the accuracy of these refunds before forwarding the requests to Accounts Payable.

  - o AP staff then verify the refund recipient's name, address, and refund amount before posting the voucher.

- Standardized check (30% of manual AP vouchers) and ACH requisition (3% of manual AP vouchers) forms have been developed and are required to be completed for a payment requisition to be processed.

  o Current Accounts Payable procedures ensure that a check requisition for more than $5,000 is approved by a department director, ACH requisitions for more than $25,000 are approved by a department director, and that there is some evidence of receipt such as an invoice.

  o Purchasing policy only requires check requisitions to be approved above $5,000; however, check requisitions for reimbursable employee expenses is prohibited. Current practices exceed the requirements of the purchasing policy and thus should be updated.

- Employees must submit the appropriate form in order to be reimbursed or paid in advance for business related expenses.

  o To receive a travel advance (8% of manual AP vouchers), the online travel authorization form must be approved, and an approved travel advance form must be filled out and submitted to AP. Employees are required to justify these expenses after their travel is complete within 20 working days.

  o Current Accounts Payable procedures require proof of received goods or services and supervisory approval in order to be reimbursed (13% of manual AP vouchers) such as receipts, conference, brochures, mapped directions for mileage, etc. In addition, travel must have been preapproved using the online travel authorization form. The City allows for either per diem or receipted meals to be reimbursed.

- A small number of invoices and statements are paid by Accounts Payable staff without formal approval or receipt documentation (5% of manual AP vouchers). These payments are not addressed in the Procurement Manual.

Controls Over Payment Disbursements are Generally Adequate

While Accounts Payable is responsible for verifying the obligation to pay, best practices suggest segregating the duties of this responsibility, authorizing the payments being made, and reconciling payments to the bank statement. Periodically, organizations initiate payment authorization via the payment disbursement process, which generally includes three stages:

1) Preparations of payment information to be forwarded to suppliers (checks) or the City's bank (ACH);

2) Review of prepared payment information; and

3) Dispersal of payments to suppliers.

The auditors found the following:

- Weekly, Accounts Payable staff initiate the disbursement process. All vouchers posted during the week are summarized and reconciled to ensure that payments are processed correctly.

- o Access to JD Edwards' Accounts Payable functions is restricted via user security groups that are managed by Technology Services.

  - ▪ We identified one City employee with unauthorized AP access; this access has since been removed. This being said, there is no way in the system to verify that these functions were not used by the unauthorized employee. Adequate compensating controls exist.

- Check printing is then overseen by the City's Reprographics and Accounting staff and the ACH payment files are prepared by the Controller's office.

  - o Check stock is adequately secured, and signatures are maintained by the City's Technology Services Department. A check log is maintained by the Reprographics Division and certified by Accounting staff after each check run.

- Accounting staff reverifies the obligation to pay for checks issued for more than $5,000 after printing and the Controller's office spot checks ACH and check payment files.

- ACH payments and the check positive pay files are uploaded to the bank's website by the Controller's office.

  - o The bank verifies the integrity of these files and notifies the City that they have been received and are being processed. Any checks attempted to be negotiated that are not verified to the positive pay file are reviewed by the Accounts Payable Supervisor before payment or denial. ACH payment files include the invoice numbers being paid. If an ACH payment cannot be routed, the City is notified by the bank.

Opportunities for Improvement

As discussed previously, many controls exist to ensure that the City is only making appropriate payments. This being said, our office has identified some areas where strengthening controls could mitigate remaining risk.

Payment Procedures Should be Updated and Expanded

According to best practices, every organization should have a policies and procedures manual for their Accounts Payable function.

What We Found?

- Accounts Payable has developed some written payment process information that is included in the City's Materials Management and Payment Procedures Manual. These procedures cover the following information:
  - o Review and approval of check requisitions;
  - o Purchase order three-way matching processes;
  - o Travel advances and expenses approval and reporting;
  - o Refund processing; petty cash reconciliation;
  - o Check processing schedule and emergency check run requests;
  - o Wire payment requests and approvals; and
  - o Retention policies for payment supporting documentation.

- Not all payment procedures within the Materials Management and Payment Procedures Manual appear to be up-to-date based on current practices as determined during conversations with AP staff.

Why Does It Matter?

A formalized policies and procedures manual helps an organization retain institutional knowledge, navigate emergency situations, and facilitate consistency. While the Materials Management and Payment Procedures Manual does include some written procedures information, it is generally aimed towards departments – meaning not all information relevant to Accounts Payable is covered. In addition, if the manual is not updated regularly, it may not reflect current procedures and practices – essentially becoming obsolete.

Recommendation:

1. Update and formalize an accounts payable policies and procedures manual. Current procedures documentation can be utilized in this effort. Policies and procedures manuals should be reviewed annually and updated if necessary.

   Finance Comments: The process to update policies and procedures is under way. Staff has received examples from multiple cities utilizing the same financial software. These examples

will assist in drafting changes to the policies and procedures manual. We want to ensure comprehensive policies are appropriately formal and cover all aspects of Accounts Payable practices and procedures.

Critical Purchasing System Access Needs to be Reviewed

The Government Accountability Office's Standards for Internal Control in the Federal Government states that "management should consider the need to separate control activities related to authority, custody, and accounting of operations to achieve adequate segregation of duties." Ideally, this means that the following duties should be performed by different functions:

- Procurement Requisition/Approval
- Purchase Order Issuance

- Goods Receipt
- Accounts Payable/Payment Disbursement

What We Found?

Critical purchasing system access within JD Edwards is restricted or granted through a series of security groups. All JD Edwards users are granted access to enter a requisition and a receiver unless this access is specifically removed through a security group. We reviewed the access of six users in a JD Edwards test environment created by Technology Services to better understand the access restricted and granted by the eight applicable purchasing security groups.[4] The results are divided up by function below:

Approvers
- The GENAPPROV security group restricts the user from creating a requisition and grants the ability to approve a requisition. No Accounts Payable or Warehouse employees are in this group and two Procurement supervisors are in this group.

Accounts Payable
- The ACCTPAY security group grants users access to Accounts Payable functions; however, it does not restrict a user's ability to add requisitions or receipts.

- The ACCTPAYSV security group grants additional access to modify refund recipients' addresses and indicate which suppliers should receive a 1099 – this group does not restrict the user's ability to add requisition and receipts.

Warehouse
- The WAREHOUSE security group grants users access to Warehouse requisition and receiving functions and appears to be generally appropriate.

- The WAREHOSUPV security group appears to restrict the user from creating receipts, but instead grants the user access to reverse receipts.

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[4] JDE security groups applicable to purchasing controls include: 1) GENAPPROV, 2) ACCTPAY, 3) ACCTPAYSV, 4) WAREHOUSE, 5) WAREHOSUPV, 6) PURCHASST, 7) PURCH, and 8) PURCHSUPR.

Procurement
- The PURCH & PURCHASST security groups grant users access to create & modify purchase orders, convert requisitions to purchase orders, and to modify the supplier master.

- The PURCHASST security group restricts the user's ability to add a receipt; however, this ability is not restricted for the PURCH group and neither group restricts a user's ability to enter a requisition.

- The PUCHSUPR security group appears to restrict the user from creating receipts, but instead grants the user access to reverse receipts. In addition, this group appears to remove the users access to create a purchase order; however, it allows the user to modify a purchase order and convert requisitions to purchase orders.

Why Does It Matter?

Allowing employees to perform incompatible duties within the system increases the risk of fraud, waste, and abuse. For example, it appears that under the current circumstances, it is potentially possible for a procurement employee to create a fake supplier, enter a purchase order for this supplier, and receive on this purchase. Once this is completed, the employee could create a fake invoice in order to receive payment, which is possible with available software. In addition to the above weakness, at least two individuals appear to be "superusers," which may grant them even greater access to incompatible duties. If this access is abused, it may not be detected in a timely manner.

Recommendations:

2. Finance and Procurement need to ensure that Accounts Payable and Procurement staff do not have incompatible system access. Particularly, these functions should not be able to requisition orders, receive purchases, and make changes to supplier master if they can issue purchase orders or disburse payments.

   Finance Comments: *Tech Services has now restricted the Accounts Payable Staff's ability to add purchase order requisitions and enter receipts.*

   Purchasing Comments: *Tech Services is working to create more restrictive user groups for Procurement Staff's system access to differentiate between the users who approve requisitions and the users who have access to the supplier master file.*

Duplicate Payment Controls Need Improvement

As mentioned previously, the primary purpose of an Accounts Payable function is to verify the organization's obligation to pay. Ensuring that payments are not being made twice is an essential step in this verification process. While most invoices have unique numbers, some reoccurring payments use the same invoice number, requiring staff to create a unique number.

What We Found?

- The JD Edwards system contains a standard duplicate payment report that may be run by Accounts Payable staff. This report identifies payments made to a supplier with the same invoice number and transaction amount.

    o Accounts Payable does not have a formalized invoice numbering policy.

- Accounts Payable does not have a procedure for verifying that submitted invoices have not been paid with a procurement card.

    o According to staff, this is because they do not have access to procurement card transaction information as this program is managed by the Procurement & Compliance Department.

Why Does It Matter?

Currently, Accounts Payable staff must rely on employees to notify them if an invoice has been paid via p-card. Additionally, without a standardized invoice numbering guideline, Accounts Payable staff run the risk of paying an invoice twice by entering slightly different invoice numbers. The risk of duplicating payments should be minimized in order to avoid inappropriate and unnecessary expenditures.

Recommendations:

3. Include a standard invoice numbering guideline within the policies and procedures manual. This policy should promote consistency and decrease the risk of duplicate payments.

    Finance Comments: The standard invoice numbering practice will be incorporated into the updated Policy Manual.

4. Consider developing a procedure to verify that certain invoices have not already been paid on a procurement card.

    Finance Comments: Staff has been exploring ways to compare invoices paid by p-cards to invoices processed thru the Accounts Payable system. The only common data between the two systems is the date of transaction and the amount. The P-card system does not use the Vendor Master numbering system and the transaction number on the receipt is not in the JDE system. We are currently installing a new travel and p-card software which should enhance shared between the two systems to find data points that we can be used to search for duplicate transactions. Ultimately, the payments are from separate systems and staff will implement all procedures policy to mitigate the risk.

Some Exempted Taxes Have Been Paid

According to the Texas Administrative Code Section 3.322, the purchase, lease, or rental of a taxable item is always exempt from taxes when made by "any county, city, special district or other political subdivision of the State of Texas, and any college or university created or authorized by the State of Texas."

What We Found?

- As part of a targeted review, we identified about $1,300 disbursed during fiscal year 2018 to pay sales taxes from which the City is exempt. It should be noted that the reviewed payments do not represent all payments made to these suppliers and so are most likely are not the total exempt tax payments made by the City.

  o These sales tax payments were not detected by Accounts Payable or Accounting staff.

- City staff have begun seeking reimbursement for these tax payments and have received about $6,700. Additional reimbursement of at least $8,000 is expected.

Why Does It Matter?

Under Texas state law, municipal governments are exempt from paying sales and use taxes. While the City is typically mindful of this exemption, at least $1,300 was disbursed inappropriately despite staff review. In the future, a process should be established to ensure these billing issues are detected by Finance staff.

Recommendations:

5. Establish a process to ensure the City is not paying any taxes for which it is exempt.

   Finance Comments: Accounting staff is consistently being reminded to check for sales taxes being billed on vendor invoices while reviewing the Accounts Payable check run. Also, Accounts Payable staff has the responsibility to reduce any sales tax charges and file the proper paper work with the vendor to exempt any future sales tax charges. These practices will be incorporated into the updated Policy and Procedures Manual.

Receiving Documentation Can be Improved

As mentioned previously, most of the City's purchases (about 57% or $222.9 million) utilize the three-way match system control in JD Edwards.[5] Typically, this system requires the quantities and amounts ordered on the purchase order to match the quantities received on the receiving document and the amount charged on the invoice; this is illustrated in Table 2.

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[5] 28% of payments have controls to adequately assure payments are made appropriately; controls over the remaining 15% are addressed in the remaining sections of this report.

Table 2: Three-Way Match Control Summary

Document Type	Quantities	Amount
Purchase Order	Yes	Yes
Receiving Document	Yes	
Invoice		Yes

While the City's current three-way match procedures provide some assurance of receipt, we found the following weaknesses:

What We Found?

- Within each department, the receiving process is generally centralized with an Administrative Assistant; however, all JD Edwards users can create electronic receiving documents in the system.

- JD Edwards three-way match control is currently setup to require lump sum, dollar amount receiver information, which may force employees to wait until the invoice is obtained to complete receiving information. Completing receiving documentation based on an invoice hinders a true three-way match control measure and does not provide adequate assurance of the obligation to pay.

- While some departments are uploading adequate receiving documents in JD Edwards, this information is not consistently provided to or reviewed by Accounts Payable staff.

  - For instance, Warehouse staff attach a text document with the quantities received for each line item on a purchase order. On the other hand, Technology Services stamps invoices as "received" and signs and dates the stamp; these certified invoices are then forwarded to Accounts Payable.

Why Does It Matter?

The three-way match is one of the strongest payment controls as it provides assurance that the organization is paying the price agreed upon and receiving the desired quantities and specifications of the items ordered. While an electronic receiving document provides some assurance that the goods ordered were delivered, lump sum matching bypasses the quantity verification process. This requirement potentially limits the control to a two-way match if an invoice must be used to enter the receiver, which is inadequate. Additionally, the centralization of receiver entry – despite system flexibility – increases the risk that goods or services will be paid for before being received or despite potential quality issues, especially when using an invoice as the receiver.

According to staff, the City began using lump sum matching due to difficulties with supplier quantity conventions (e.g. the City ordered 3 cases of paint, but the packing slip lists 15 cans of paint). While it may slow down the payment process, the City could require departments to use the supplier's quantity conventions or require the supplier to use the quantity conventions as described on the purchase order to provide adequate assurance that all goods ordered were received.

Recommendations:

6. Require employees to enter adequate receiving documentation for all goods and services. Particularly, the City should require staff to verify the quantities of goods, or potentially even services, received by departments.

   Finance Comments: As part of the update to the Accounts Payable Policy and Procedures manual, we will require the department personnel to upload an image of the receiving or shipping document with the invoice as a reference for City staff when processing payments to the vendor.

7. Consider requiring the employee who physically receives goods or services to enter the receiving document in JD Edwards via policy. In order to implement this policy, additional training or procedures material may need to be made available.

   Finance Comments: Agree. As part of the update to the Accounts Payable Policy and Procedures manual, we will require the department personnel to upload an image of the receiving or shipping document with the invoice as a reference for City staff when processing payments to the vendor.

Some Check Requisition and Dispersal Practices are Inappropriate

Minimizing the number of checks an organization issues will reduce costs related to check printing, mailing, and processing. Additionally, the implementation of several security controls over the storage and dispersal of checks minimizes the risks associated with check fraud or abuse, such as theft, forgery, or misappropriation.

What We Found?

- The City of Denton printed a little over 9,900 checks – about 70% of payment transactions – during fiscal year 2018. These checks are summarized by verification type in Table 3 below:

Table 3: Check Payments by Verification Type (FY 2018)

Verification Procedure	Est. Amount (Millions)	Est. Vouchers	Controls
Three-Way Match	$73.0	5,102	Some
Manual AP	$1.1	4,827	Some
Refunds	*$0.2*	*2,206*	*Adequate*
Payment Req.	*$0.7*	*1,379*	*Some*
Reimb. & Adv.	*$0.1*	*965*	*Adequate*
Non-PO	*$0.2*	*276*	*Some*
All:	$74.2	9,929	N/A

- As mentioned previously, check stock controls are generally adequate; however, some check requisitions and dispersals practices should be prohibited, namely:

  o Check requisitions under $5,000 do not require approval by a supervisor; while Accounts Payable typically requires an invoice from an authorized vendor to post a voucher, these controls do not adequately compensate for a deficiency in supervisory controls, which may allow it to be abused.

     o   Accounts Payable practices allow suppliers' checks to be collected and hand delivered by an employee to a vendor.

Why Does It Matter?

Supervisory review and approval are the most critical control over employee purchases as supervisors are able to review requisitions to verify that a legitimate business purpose exists. Conversely, reviews by Purchasing or Accounts Payable are intended to ensure compliance with state and federal regulations and City policies.

In addition, allowing employees to collect checks for vendors increases the opportunity for fraud – especially given some areas of relatively weak supervisory control. In the current process, a City employee may set up a vendor account by completing a W-9 form. If this vendor account is used to process an invoice under 5,000, the current process may allow issuing a check because the supervisory controls are weak. The controls are further compromised due to employees' collection of checks. While a check log is maintained it does not necessarily protect against fraudulent invoice payment or individuals taking advantage of check cashing establishments that do not require identification. Fraud using this method is very common and the City must have proper safeguards to prevent it.

Recommendations:

8. Require check requisitions under $5,000 to be approved by a supervisor.

   Finance Comments: *We will distribute new forms requiring the Supervisor or Manager of the person submitting the check requisition <u>to approve the under $5,000</u> purchase. Directors already are required to approve any check Requisition over $5,000.*

9. Restrict physical collection of checks. Physical collection of checks should be minimized, and any allowable exceptions should be formalized via policy.

   Finance Comments: *All Vendor checks will be mailed in the future. We will inform our vendors and City staff that we will no longer release check payments. We will encourage our vendors to choose ACH payments as an alternative. Exceptions to this policy will be allowed on a case by case basis.*

10. Encourage the use of electronic payments instead of paper checks where possible.

    Finance Comments: *Agree. The Procurement Office is responsible for setting up the Vendor Masters, including the method of payment the Vendor chooses. We also follow up with reviews of vendor payment registers to look for and request vendors to setup ACH Payments to eliminate the need for paper checks.*

Staples Advantage Features are not Adequately Utilized

The City of Denton's Materials Management and Payment Procedures Manual allows employees to order office supplies online through the Staples Advantage website.

What We Found?

Supervisory Controls

- In order to obtain access to the Staples Advantage website, an employee must complete and submit a user request form and be approved by Procurement & Compliance Department staff.

  o The City currently has 176 active Staples Advantage users. 32 of these users have never logged on to the Staples Advantage website; an additional 39 users had not ordered an item since January 2018.

- Once access has been obtained, employees may order items from the Staples Advantage website. This website offers several items that can be personally consumed by individuals. Documented approval of purchases is not required, and maximum spending levels are not set. Additionally, while employees do receive a packing slip, it is often not signed.

Billing Process Efficiency

- In addition, the City is currently billed for Staples Advantage purchases each time items on an order are delivered. This means that if three items were ordered, but were delivered on two separate days, the City would receive two invoices for the same order.

  o During April 2019, the City received 347 unique invoices. Some individuals received multiple invoices on the same day – about 36% of invoices received fell into this category.

  o During fiscal year 2018 the City received just over 2,800 unique Staples invoices. These composed about 6% of annual accounts payable vouchers, but the Staples payments represented only 0.1% of the total amount disbursed during the year.

Why Does It Matter?

Supervisory Controls

During the month of April 2019, we did not find significant evidence of abuse of these control deficiencies; however, without increased supervisory control, employees could easily order items for personal use without being discovered.

In addition, we identified several opportunities for potential cost savings. For example, eleven keyboards were purchased: the cheapest cost $23 while the most expensive cot $76 – a different of almost $50. While these amounts may seem small, the City has a duty to be good stewards of the public's money. Without supervisory controls, employees may not use cost effective purchasing practices.

According to the City's Staples' Account Manager, the Staples Advantage website offers approval functionality that could be utilized with increased participation. In addition, the City currently has

several other methods of procurement (e.g. the purchase order process and procurement cards) that could be used to increase supervisory controls.

Billing Process Efficiency

According to the City's Staples' Account Manager, Staples Advantage offers several different billing methods that could decrease the number of invoices received by Accounts Payable – potentially increasing their efficiency. Exploring the above options will increase efficiency in Accounts Payable function.

Recommendations:

11. Develop a process to ensure Staples Advantage purchases are properly approved and received.

    Finance Comments: *All Staples invoices should include a PO number so that the purchases are authorized by department management and we can process the payment using the Accounts Payable system to match the PO and receiver against the invoice amount. We are anticipating adding software that will automate the processing of invoices received from our vendors. Using PO number on the Staples purchases will leverage the automation and speed the process of paying all of our vendor invoices including Staples.*

12. Annually review Staples Advantage users to verify that access is still appropriate.

    Finance Comments: *We agree that an annual review of city staff access to order from Staples should be performed to maintain the proper access of personnel and will be incorporated into the updated Policy and Procedures Manual.*

    Purchasing Comments: *The control of access to the Staples Advantage is with the Procurement Office. The Purchasing Office will request a user list from Staples annually or however frequently, as needed. Purchasing will send the list out to the departments to verify the users and then ask Staples to make the requested changes.*

13. Consider changing current Staples Advantage billing practices to improve efficiency in the Accounts Payable Division.

    Finance Comments: *We are anticipating adding software that will automate the processing of invoices received from our vendors. This will speed the process of paying all of our vendor invoices including Staples. Having a PO number on the invoice is key to the automation process. We will change our procedures to effectively leverage the ability of the software to scan and voucher a vendor's invoice to make the payment process more efficient.*

    Purchasing Comments: *We do not have the ability to change Staples' billing practices or procedures. We can limit the number of City staff that have access to order from Staples and agree that this should be reviewed annually to ensure the proper employees have access.*

Appendix A: Management Response Matrix

The following summarizes the recommendations issued throughout this report. The auditors found that staff were receptive and willing to make improvements to controls where needed. Management's responses to each recommendation is summarized below:

1	*Update and formalize an accounts payable policies and procedures manual.*	**Concur**	Expected Completion: December of 2019
Finance Comments: The process to update policies and procedures is under way. Staff has received examples from multiple cities utilizing the same financial software. These examples will assist in drafting changes to the policies and procedures manual. We want to ensure comprehensive policies are appropriately formal and cover all aspects of Accounts Payable practices and procedures.			Responsibility: Melanie Beard, Brian Hogan, and Harvey Jarvis
2	*Finance and Procurement need to ensure that Accounts Payable and Procurement staff do not have incompatible system access.*	**Concur**	Expected Completion: Completed
Finance Comments: Tech Services has now restricted the Accounts Payable Staff's ability to add purchase order requisitions and enter receipts. Purchasing Comments: Tech Services is working to create more restrictive user groups for Procurement Staff's system access to differentiate between the users who approve requisitions and the users who have access to the supplier master file.			Responsibility: Jim Barnes, Harvey Jarvis
3	*Include a standard invoice numbering guideline within the policies and procedures manual.*	**Concur**	Expected Completion: December of 2019
Finance Comments: The standard invoice numbering practice will be incorporated into the updated Policy Manual.			Responsibility: Melanie Beard, Brian Hogan, and Harvey Jarvis
4	*Consider developing a procedure to verify that certain invoices have not already been paid on a procurement card.*	**Concur**	Expected Completion: Unknown
Finance Comments: Staff has been exploring ways to compare invoices paid by p-cards to invoices processed thru the Accounts Payable system. The only common data between the two systems is the date of the transaction and the amount. The P-card system does not use the Vendor Master numbering system and the transaction number on the receipt is not in the JDE system. We are currently installing a new travel and p-card software which should enhance shared between the two systems to find data points that we can use to search for duplicate transactions. Ultimately, the payments are from separate systems and staff will implement all procedures policy to mitigate the risk.			Responsibility: Brian Hogan and Harvey Jarvis

5	*Establish a process to ensure the City is not paying any taxes for which it is exempt.*	**Concur**	Expected Completion: December of 2019
Finance Comments: Accounting staff is consistently being reminded to check for sales taxes being billed on vendor invoices while reviewing the Accounts Payable check run. Also, Accounts Payable staff has the responsibility to reduce any sales tax charges and file the proper paper work with the vendor to exempt any future sales tax charges. These practices will be incorporated into the update Policy and Procedures Manual.			Responsibility: Melanie Beard, Brian Hogan and Harvey Jarvis
6	*Require employees to enter adequate receiving documentation for all goods and services.*	**Concur**	Expected Completion: September of 2019
Finance Comments: As part of the update to the Accounts Payable Policy and Procedures manual, we will require the department personnel to upload an image of the receiving or shipping document with the invoice as a reference for City staff when processing payments to the vendor.			Responsibility: Department personnel and the Accounts Payable staff
7	*Consider requiring the employee who physically receives goods or services to enter the receiving document in JD Edwards via policy.*	**Concur**	Expected Completion: September of 2019
Finance Comments: Agree. As part of the update to the Accounts Payable Policy and Procedures manual, we will require the department personnel to upload an image of the receiving or shipping document with the invoice as a reference for City staff when processing payments to the vendor.			Responsibility: Department personnel and the Accounts Payable staff
8	*Require check requisitions under $5,000 to be approved by a supervisor.*	**Concur**	Expected Completion: September 30, 2019
Finance Comments: We will distribute new forms requiring the Supervisor or Manager of the person submitting the check requisition <u>to approve the under $5,000 </u>purchase. Directors already are required to approve any check requisition overt $5,000.			Responsibility: Melanie Beard and Brian Hogan
9	*Restrict physical collection of checks.*	**Concur**	Expected Completion: September 30, 2019
Finance Comments: All Vendor checks will be mailed in the future. We will inform our vendors and City staff that we will no longer release check payments. We will encourage our vendors to choose ACH payments as an alternative. Exceptions to this policy will be allowed on a case by case basis.			Responsibility: Melanie Beard and Harvey Jarvis
10	*Encourage the use of electronic payments instead of paper checks where possible.*	**Concur**	Expected Completion:

			Already being done
Finance Comments: Agree. The Procurement Office is responsible for setting up the Vendor Masters, including the method of payment the Vendor chooses. We also follow up with reviews of vendor payment registers to look for and request vendors to setup ACH Payments to eliminate the need for paper checks.			Responsibility: Melanie Beard and Harvey Jarvis
11	*Develop a process to ensure Staples Advantage purchases are properly approved and received.*	**Concur**	Expected Completion:
Finance Comments: All Staples invoices should include a PO number so that the purchases are authorized by department management and we can process the payment using the Accounts Payable system to match the PO and receiver match against the invoice amount. We are anticipating adding software that will automate the processing of invoices received from our vendors. Using PO number on the Staples purchases will leverage the automation and speed the process of paying al of our vendor invoices including Staples.			Responsibility: Melanie Beard, Brian Hogan and Harvey Jarvis
12	*Annually review Staples Advantage users to verify that access is still appropriate.*	**Concur**	Expected Completion: December of 2019
Purchasing Comments: The control of access to the Staples Advantage is with the Procurement Office. The Purchasing Office will request a user list from Staples annually or however frequently, as needed. Purchasing will send the list out to the departments to verify the users and the ask Staples to make the requested changes. Finance Comments: We agree that an annual review of city staff access to order from Staples should be performed to maintain the proper access of personnel and will be incorporated into the updated Policy and Procedures Manual.			Responsibility: Melanie Beard and Brian Hogan
13	*Consider changing current Staples Advantage billing practices to improve efficiency in the Accounts Payable Division.*	**Partially Concur**	Expected Completion: June of 2020
Finance Comments: We are anticipating adding software that will automate the processing of invoices received from our vendors. This will speed the process of paying all of our vendor invoices including Staples. Having a PO number on the invoice is key to the automation process. We will change our procedures to effectively leverage the ability of the software to scan and voucher a vendor's invoice to make to payment process more efficient. Purchasing Comments: We do not have the Ability to change Staples' billing practices or procedures. We can limit the number of City staff that have access to order from Staples and agree that this should be reviewed annually to ensure the proper employees have access.			Responsibility: Melanie Beard, Brian Hogan and Harvey Jarvis

AUDIT OF ACCOUNTS PAYABLE

Follow-Up Report

ABSTRACT

Improvements have been made to further ensure City purchases of around $510 million are appropriately supported and approved. Plans to further automate accounts payable processes should provide additional assurance that payments are not duplicated.

Internal Audit Department

City Auditor
Madison Rorschach, CIA, CGAP

Audit Staff
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Project #: 007

Table of Contents

Follow-Up at a Glance

Why we did this Follow-Up:

This report is intended to provide information on what changes have been made in response to the Accounts Payable Audit issued in October 2019. The original audit evaluated the effectiveness of controls over accounts payable in order to properly record and safeguard the spending of municipal funds. This follow-up is included on the City's Fiscal Year 2020-21 Audit Plan as approved by the City Council.

What we Found:

A newly adopted Cash Disbursements Policy has provided additional guidance to Accounts Payable and department staff including formalizing standards for receiving documentation and improving controls over the processing of checks. In addition, Accounts Payable has begun automating invoice and payment request processing, which should help reduce the risk of duplicate payments. Finally, the City has generally begun requiring supervisor approval for all Staples purchases; however, additional oversight should further minimize the risk of inappropriate purchases. The status of each recommendation is summarized below:

Recommendation	Mgmt. Response	Status
1. Formalize an AP policies & procedures manual.	Concur	Implemented
2. Ensure AP & Purchasing Staff don't have incompatible system access.	Concur	In Progress
3. Include standard invoice numbering guideline in policies & procedures manual.	Concur	In Progress
4. Consider developing a procedure to verify invoices weren't paid via p-card.	Concur	In Progress
5. Establish process to ensure the City isn't paying exempt taxes.	Concur	Implemented
6. Require employees to enter adequate receiving documentation for all goods & services.	Concur	Implemented
7. Consider requiring employees who physically receive goods & services to enter receiving documentation.	Concur	Implemented
8. Require check requisitions under $5,000 to be approved.	Concur	Implemented
9. Restrict physical collection of checks.	Concur	Implemented
10. Encourage use of electronic payments.	Concur	In Progress
11. Ensure Staples purchases are approved & received.	Concur	In Progress
12. Annually review Staples users to verify access.	Concur	In Progress
13. Consider changing Staples billing practices to improve efficiency in the AP Division.	Partially Concur	Implemented

Audit report translations may be requested by emailing InternalAudit@CityofDenton.com.

Introduction

The Internal Audit Department is responsible for providing: (a) an independent appraisal[1] of City operations to ensure policies and procedures are in place and complied with, inclusive of purchasing and contracting; (b) information that is accurate and reliable; (c) assurance that assets are properly recorded and safeguarded; (d) assurance that risks are identified and minimized; and (e) assurance that resources are used economically and efficiently and that the City's objectives are being achieved.

The Internal Audit Department has completed a follow-up review of the Accounts Payable Audit issued in October 2019. We conducted this performance audit 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.

Management Responsibility

City management is responsible for ensuring that resources are managed properly and used in compliance with laws and regulations; programs are achieving their objectives; and services are being provided efficiently, effectively, and economically.

Audit Objectives, Scope, and Methodology

This report is intended to provide a progress update on recommendations from the Accounts Payable Audit (October 2019), which evaluated the effectiveness of controls over accounts payable in order to properly record and safeguard the spending of municipal funds.

Audit fieldwork was conducted during February and March 2021. The scope of review varied depending on the procedure being performed. The following list summarizes the major procedures performed:

- Reviewed documentation from the issued audit to develop criteria including industry standards, best practices, policies, and procedures;

- Evaluated the City of Denton's Cash Disbursements policy approved on January 26, 2021;

- Analyzed payments and vouchers issued during calendar year 2020;

- Examined supporting documentation for a randomly selected statistical sample[2] of 95 payments issued during calendar year 2020;

- Inspected user access reports for the City's Staples Advantage and JD Edwards systems; and

- Interviewed City staff from the Accounts Payable Division and the Finance, Procurement & Compliance, and Technology Services Departments.

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[1] The City of Denton Internal Auditor's Office is considered structurally independent as defined by generally accepted government auditing standard 3.56.

[2] This sample provides with 95% confidence that the true population is ±10% of the sample estimate.

Recommendation Status Update

This report summarizes the Audit of Accounts Payable recommendations, management responses, and the Internal Audit Department's follow-up findings, which describe to what extent City management has implemented Internal Audit's recommendations since the publication of the original report (October 2019).

Most simply, it is the function of an accounts payable division to verify an organization's obligation to pay suppliers and other entities that are owed money by an organization. In the City of Denton, this obligation to pay is verified in three ways: 1) automated three-way matching, 2) manual review by the Treasury Division, and 3) manual review by the Accounts Payable Division.

Table 1: Obligation to Pay Verification Summary (CY2020)

Verification Procedure	No. of Payments	Est. Payment Amount (Millions)
Three-Way Match	6,760	$153.7
Manual Treasury	699	$354.1
Manual AP	3,613	$3.1
Refunds	*2,331*	*$0.3*
Payment Requests	*932*	*$2.4*
Reimbursements	*117*	*$0.0*
Other	*233*	*$0.3*
All:	11,072	$510.9

Payment Procedures Should be Updated and Expanded

1. **Update and formalize an accounts payable policies and procedures manual.**

   Management Response: Concur
   Finance Comments: The process to update policies and procedures is under way. Staff has received examples from multiple cities utilizing the same financial software. These examples will assist in drafting changes to the policies and procedures manual. We want to ensure comprehensive policies are appropriately formal and cover all aspects of Accounts Payable practices and procedures.

   Audit Follow-Up Finding: Implemented
   The City Council adopted a new Cash Disbursements policy on January 26, 2021 via ordinance. This policy includes roles and responsibilities for Accounts Payable, Procurement, and departments making and approving purchases with regards to the payment process.

Critical Purchasing System Access Needs to be Reviewed

2. **Finance and Procurement need to ensure that Accounts Payable and Procurement staff do not have incompatible system access.**

   Management Response: Concur
   Finance Comments: Tech Services has now restricted the Accounts Payable Staff's ability to add purchase order requisitions and enter receipts.

   Purchasing Comments: Tech Services is working to create more restrictive user groups for Procurement Staff's system access to differentiate between the users who approve requisitions and the users who have access to the supplier master file.

Audit Follow-Up Finding: In Progress

Currently, there are seven security groups in the City's financial system involved in the vendor payment process as shown below:[3]

Table 2: Financial System Payment Process Security Groups

Accounts Payable	Purchasing	Warehouse
ACCTPAY	PURCHASST	WAREHOUSE
ACCTPAYSV	PURCH	WAREHOSUPV
	PURCHSUPR	

These security groups restrict access within the City's financial system so that users only have access to the functions needed to perform their duties. Ideally, duties within the purchase process should be segregated to minimize the risk of abuse. These duties include:

- Procurement Requisition/Approval
- Purchase Order Issuance
- Receipt of Goods
- Accounts Payable/Payment Disbursement

Based on a review of changes made to these security groups, some access has been restricted to ensure users do not have incompatible system access. In particular, Accounts Payable representatives are no longer able to enter procurement requisitions. That being said, the following inappropriate actions still appear possible:

- Accounts Payable staff (i.e. ACCTPAY and ACCTPAYSV groups) appear to be able to enter receipts for goods;

- Purchasing staff (i.e. PURCHASST and PURCH groups) appear to be able to create procurement requisitions; and

- Some Purchasing staff (i.e. PURCH group) appear to be able to enter receipts for goods.

In addition, the number of superusers – or those users in more than one security group – appears to have increased for the Warehouse function. This may grant these users even greater access to incompatible duties. If this access is abused, it may not be detected in a timely manner.

Duplicate Payment Controls Need Improvement

3. **Include a standard invoice numbering guideline within the policies and procedures manual.**

   Management Response: Concur
   Finance Comments: The standard invoice numbering practice will be incorporated into the updated Policy Manual.

   Audit Follow-Up Finding: In Progress
   The new Cash Disbursements policy, implemented in January 2021, does not include a standard invoice numbering guideline; however, the Finance Department plans to address this issue once a fully automated Accounts Payable software is implemented.

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[3] City departments must work with the Technology Services Department in order to make changes to security groups in the City's financial system.

That being said, the City has begun using a semi-automated accounts payable processing system. Through this system, department staff submit invoices for payment to a cloud-based application for Accounts Payable representatives to process. This system includes a duplicate invoice verification procedure that automatically determines if the invoice has been entered into the database twice based on vendor name and invoice number.

There is a possibility that duplicate invoices are not caught due to data entry errors. Accounts Payable staff believe this issue could be minimized through implementation of a fully automated accounts payable system. Finance is currently preparing a solicitation for this type of system; funding for this implementation was included in the fiscal year 2020-21 budget.

4. **Consider developing a procedure to verify that certain invoices have not already been paid on a procurement card.**

    Management Response: Concur
    Finance Comments: Staff has been exploring ways to compare invoices paid by p-cards to invoices processed thru the Accounts Payable system. The only common data between the two systems is the date of the transaction and the amount. The P-card system does not use the Vendor Master numbering system and the transaction number on the receipt is not in the JDE system. We are currently installing a new travel and p-card software which should enhance shared between the two systems to find data points that we can use to search for duplicate transactions. Ultimately, the payments are from separate systems and staff will implement all procedures policy to mitigate the risk.

    Audit Follow-Up Finding: In Progress
    The new Cash Disbursements policy, implemented in January 2021, does not include a process for Accounts Payable representatives to verify that invoices have not been paid via procurement card. According to Finance staff, they plan to begin sending a list of items scheduled to be paid to the City's procurement card monitoring vendor each week. The vendor will then provide a report of possible items to double check before payments are issued.

    In addition, Procurement sends a list of the City's contracts to the City's procurement card monitoring vendor each month. Using this list, the monitoring vendor identifies purchases that could potentially have been on contract and provides these exceptions to Procurement staff for review. This process could potentially identify payments that may have also gone through the accounts payable process.

Some Exempted Taxes Have Been Paid

5. **Establish a process to ensure the City is not paying any taxes for which it is exempt.**

    Management Response: Concur
    Finance Comments: Accounting staff is consistently being reminded to check for sales taxes being billed on vendor invoices while reviewing the Accounts Payable check run. Also, Accounts Payable staff has the responsibility to reduce any sales tax charges and file the proper paper work with the vendor to exempt any future sales tax charges. These practices will be incorporated into the updated Policy and Procedures Manual.

    Audit Follow-Up Finding: Implemented
    According to Finance staff, Accounts Payable manually verifies that invoices received do not include exempt taxes as part of their standard review process. If exempted taxes are included, the amount is

deducted from the issued check and the vendor is notified of the City's exempt status. Based on a sample review of 95 payments, no exempt taxes were paid.

Receiving Documentation Can be Improved

6.   Require employees to enter adequate receiving documentation for all goods and services.

Management Response: Concur
Finance Comments: As part of the update to the Accounts Payable Policy and Procedures manual, we will require the department personnel to upload an image of the receiving or shipping document with the invoice as a reference for City staff when processing payments to the vendor.

Audit Follow-Up Finding: Implemented
The new Cash Disbursements policy, implemented in January 2021, states "appropriate documentation to support expenditures is the detailed, itemized original 'invoice' or receipt listing the items purchased." This policy clarifies what is considered adequate receiving documentation for goods and services. This standard was not previously set.

Based on a sample review of 95 payments issued during calendar year 2020, only one appeared to have receiving documentation that may be inadequate. In addition, based on this review, more purchase orders for goods appeared to use a quantity and price order method instead of a lump sum. The quantity and price methodology for purchase orders provides further assurance that goods are received before payment because staff entering the receiver must enter the quantity of the goods received instead of just the invoiced cost.

7.   Consider requiring the employee who physically receives goods or services to enter the receiving document in JD Edwards via policy.

Management Response: Concur
Finance Comments: Agree. As part of the update to the Accounts Payable Policy and Procedures manual, we will require the department personnel to upload an image of the receiving or shipping document with the invoice as a reference for City staff when processing payments to the vendor.

Audit Follow-Up Finding: In Progress
The new Cash Disbursements policy, implemented in January 2021, requires employees to "obtain detailed, itemized transaction documentation for all purchases, review and verify the validity of all transactions, reconcile transaction to documentation, indicate proper general ledger account coding for transactions and submit required records to the Approver." This new policy appears to place the responsibility for ensuring all goods and services are appropriately received on the employee making the purchase, while still giving departments the flexibility to centralize receiver input.

Some Check Requisition and Dispersal Practices are Inappropriate

8.   Require check requisitions under $5,000 to be approved by a supervisor.

Management Response: Concur
Finance Comments: We will distribute new forms requiring the Supervisor or Manager of the person submitting the check requisition to approve the under $5,000 purchase. Directors already are required to approve any check requisition over $5,0000.

Audit Follow-Up Finding: Implemented

The new Cash Disbursements policy, implemented in January 2021, requires that check requisitions under $5,000 be approved by a supervisor. In addition, based on a review of 95 sample payments issued during calendar year 2020, eight were vouchered by a check requisition. Of these, one was missing a supervisor's signature. This check requisition had adequate supporting documentation to verify the City's obligation to pay but was requested on the old Check Requisition Form.

Despite this oversight, the recommendation appears to be generally implemented; however, Accounts Payable staff should ensure that all check requisitions are made with the revised form and have appropriate approvals.

9. **Restrict physical collection of checks.**

Management Response: Concur
Finance Comments: All Vendor checks will be mailed in the future. We will inform our vendors and City staff that we will no longer release check payments. We will encourage our vendors to choose ACH payments as an alternative. Exceptions to this policy will be allowed on a case by case basis.

Audit Follow-Up Finding: Implemented

The new Cash Disbursements policy, implemented in January 2021, states "with very limited exceptions, all checks are to be mailed – there are no vendor pickups. Exceptions, which can be picked up by City employees only, include legal settlements, property purchases, or special requests."

Based on review of Accounts Payable's Check Pickup log, about 1% of issued checks were physically picked-up between October and December 2020. Of these, no checks were picked up by a vendor and all pickups appeared to have generally complied with the Cash Disbursements policy. Table 2 below summarizes these picked up checks:

Table 2: Check Pickups (Oct. 2020 – Dec. 2020)

Pickup Dept.	Checks	Value	Pickup Dept.	Checks	Value
Finance	3	$1,894,893.56	Parks	3	$7,463.75
Facilities	1	$179,429.96	Legal	2	$1,065.30
Real Estate	5	$45,449.05	Water	1	$285.96
Electric	1	$12,500.00	All:	16	$2,141,087.58

10. **Encourage the use of electronic payments instead of paper checks where possible.**

Management Response: Concur
Finance Comments: Agree. The Procurement Office is responsible for setting up the Vendor Masters, including the method of payment the Vendor chooses. We also follow up with reviews of vendor payment registers to look for and request vendors to setup ACH Payments to eliminate the need for paper checks.

Audit Follow-Up Finding: In Progress

The new Cash Disbursements policy, implemented in January 2021, does not include a requirement or preference for vendors to receive electronic payments. In addition, Finance and Procurement staff stated that they had not initiated any efforts since the issuance of the original audit to proactively encourage vendors to convert to electronic payments. Table 3 below shows that there has been a

percent increase in the number of electronic payments processed compared to the original audit; however, this increase does not appear to be significant.

Table 3: Electronic Payment Comparison

	FY 2018	CY 2020
Number of Electronic Payments	4,177	3,744
Percentage of All Payments	30%	34%

According to Procurement staff, they are in the process of updating their new vendor packet to include a section on the benefits of electronic payments. In addition, they intend to work with Accounts Payable to inform vendors who are not currently setup for electronic payments about that opportunity.

Staples Advantage Features are not Adequately Utilized

11. **Develop a process to ensure Staples Advantage purchases are properly approved and received.**

Management Response: Concur
Finance Comments: All Staples invoices should include a PO number so that the purchases are authorized by department management and we can process the payment using the Accounts Payable system to match the PO and receiver against the invoice amount. We are anticipating adding software that will automate the processing of invoices received from our vendors. Using PO number on the Staples purchases will leverage the automation and speed the process of paying all of our vendor invoices including Staples.

Audit Follow-Up Finding: In Progress
Since the original audit, Procurement has worked with City departments to set up approval workflows in the Staples Advantage system. Through this system, users are either classified as associates who order items or supervisors who can approve item purchases. Based on review of a February 2021 Staples Advantage User Report, all but one of the City's 90 associate users had an approval workflow setup. This exception was communicated to Procurement staff on February 23 and was subsequently corrected.

On the other hand, 78 of the 87 supervisor accounts did not have approval workflows setup. While this is true, only four of these accounts have recently ordered items from Staples. Procurement staff is currently working with Staples to block all supervisor accounts from purchasing items.

12. **Annually review Staples Advantage users to verify that access is still appropriate.**

Management Response: Concur
Purchasing Comments: The control of access to the Staples Advantage is with the Procurement Office. The Purchasing Office will request a user list from Staples annually or however frequently, as needed. Purchasing will send the list out to the departments to verify the users and ask Staples to make the requested changes.

Finance Comments: We agree that an annual review of city staff access to order from Staples should be performed to maintain the proper access of personnel and will be incorporated into the updated Policy and Procedures Manual.

Page 10

Audit Follow-Up Finding: In Progress

Based on a review of a February 2021 Staples Advantage User Report, about 27% of the City's 177 Staples Advantage accounts[4] do not have recent activity.[5] About half of these accounts are approvers.

According to Procurement staff, the Department is currently in the process of verifying Staples Advantage users for the first time since the original audit. As part of this process, departments are asked to confirm that their users still need access. In addition, Procurement staff have recently implemented several user access review processes, including a quarterly review and verification of the user report, and a weekly review to ensure employees that have recently separated from the City no longer have access to the system.

13. **Consider changing current Staples Advantage billing practices to improve efficiency in the Accounts Payable Division.**

   Management Response: Partially Concur
   Finance Comments: We are anticipating adding software that will automate the processing of invoices received from our vendors. This will speed the process of paying all of our vendor invoices including Staples. Having a PO number on the invoice is key to the automation process. We will change our procedures to effectively leverage the ability of the software to scan and voucher a vendor's invoice to make the payment process more efficient.

   Purchasing Comments: We do not have the ability to change Staples' billing practices or procedures. We can limit the number of City staff that have access to order from Staples and agree that this should be reviewed annually to ensure the proper employees have access.

   ### Audit Follow-Up Finding: Implemented
   The City has changed its billing method with Staples so that it receives an invoice for each <u>order</u> placed instead of each <u>delivery</u>. This has reduced the number of invoices received from Staples annually by about 50 percent. During calendar year 2020, About 4.4% of the City's vouchers were for Staples, and Staples payments represented about 0.2 percent of the total amount disbursed.

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[4] Some City employees have multiple Staples Advantage accounts – one that is for ordering items and another for approving purchases.

[5] For this report, recent activity means logining into the system during calendar years 2020 or 2021.

Improvements have been made to further ensure City purchases of around $723 million are appropriately supported and approved. Specifically, additional guidance has been created, system security controls have been improved, and automated payment processing procedures have been established.

Audit of Accounts Payable

Second Follow-Up Review

Audit Team

City Auditor
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Audit Staff
Amber Jackson, MBA, CFE
Kaylee White

Table of Contents

Follow-Up at a Glance

Why we did this Follow-Up:

This report is intended to provide information on what changes have been made in response to the Audit of Accounts Payable issued in October 2019. The original audit evaluated the effectiveness of controls over accounts payable in order to properly record and safeguard the spending of municipal funds. This second follow-up review was included in the City's fiscal year 2022-2023 Annual Internal Audit Plan as approved in August 2022 and amended in July 2023 by the City Council.

What we Found:

A Cash Disbursements Policy was adopted in January 2021 that provides additional guidance to Accounts Payable and department staff including formalizing standards for receiving documentation and improving controls over check processing. In addition, Accounts Payable has automated invoice and payment request processing, resolved financial system access issues, and set up a payments and p-card purchase comparison process, helping to reduce the risk of duplicate payments. Finally, the City now requires supervisor approval for all Staples purchases, reducing the risk of funds being spent inappropriately. The status of each recommendation is summarized below:

Recommendation	Mgmt. Response	Status
1. Formalize an AP policies & procedures manual.	Concur	Implemented
2. Ensure AP & Purchasing Staff don't have incompatible system access.	Concur	Implemented
3. Include a standard invoice numbering guideline in the policies & procedures manual.	Concur	Implemented
4. Consider developing a procedure to verify invoices weren't paid via p-card.	Concur	Implemented
5. Establish a process to ensure the City isn't paying exempt taxes.	Concur	Implemented
6. Require employees to enter adequate receiving documentation for all goods & services.	Concur	Implemented
7. Consider requiring employees who physically receive goods & services enter receiving documentation.	Concur	Implemented
8. Require check requisitions under $5,000 to be approved.	Concur	Implemented
9. Restrict physical collection of checks.	Concur	Implemented
10. Encourage use of electronic payments.	Concur	In Progress
11. Ensure Staples purchases are approved & received.	Concur	Implemented
12. Annually review Staples users to verify access.	Concur	Implemented
13. Consider changing Staples billing practices to improve efficiency in the AP Division.	Partially Concur	Implemented

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Recommendation Status Update

This report summarizes the Audit of Accounts Payable recommendations, management responses, and the City Auditor's Office's follow-up findings, which describe to what extent department management has implemented Audit's recommendations since the publication of the original report in October 2019.

Most simply, it is the function of an accounts payable function to verify an organization's obligation to pay suppliers and other entities that are owed money by an organization. In the City of Denton, this obligation to pay is verified in three ways: 1) automated three way-matching, 2) manual review by the Treasury Division, and 3) manual review by the Accounts Payable Division. The volume of payments verified through each of these processes between August 2022 and July 2023 is summarized in Table 1.

Table 1: Obligation to Pay Verification Summary (Aug. 2022 – Jul. 2023)

Verification Procedure	No. of Payments	Est. Payment Amount (Millions)
Three-Way Match	7,143	$428.0
Manual Treasury	926	$291.5
Manual AP	4,629	$3.9
Refunds	2,513	$0.1
Payment Requests	1,190	$3.7
Reimbursements	926	$0.1
Other	0	$0.0
All:	12,698	$723.3

Payment Procedures Should be Updated and Expanded

1. **Update and formalize an accounts payable policies and procedures manual.**

   Management Response: Concur
   Finance Comments: The process to update policies and procedures is under way. These examples will assist in drafting changes to the policies and procedures manual. We want to ensure comprehensive policies are appropriately formal and cover all aspects of Accounts Payable practices and procedures.

   Audit Follow-Up Finding: Implemented
   The City Council adopted a new Cash Disbursements policy on January 26, 2021 via ordinance. This policy includes roles and responsibilities for Accounts Payable, Procurement, and departments making and approving purchases with regards to the payment process. During the

audit, Accounts Payable staff was in the process of updating this policy to reflect changes needed due to the implementation of an accounts payable automation software; however, these have not yet been completed.

Critical Purchasing System Access Needs to be Reviewed

2. **Finance and Procurement need to ensure that Accounts Payable and Procurement staff do not have incompatible system access.**
    Management Response: Concur
    Finance Comments: Tech Services has now restricted the Accounts Payable Staff's ability to add purchase order requisitions and enter receipts.
    Purchasing Comments: Tech Services is working to create more restrictive user groups for Procurement Staff's system access to differentiate between the users who approve requisitions and the users who have access to the supplier master file.

    Audit Follow-Up Finding: Implemented
    Currently, there are seven security groups in the City's financial system involved in the vendor payment process as shown below:

    Table 2: Financial System Payment Process Security Groups

Accounts Payable	Purchasing	Warehouse
ACCTPAY	PURCHASST	WAREHOUSE
ACCTPAYSV	PURCH	WAREHOSUPV
	PURCHSUPR	

    These security groups restrict access within the City's financial system so that users only have access to the functions needed to perform their duties. Ideally, duties within the purchase process should be segregated to minimize the risk of abuse. These duties include:

    ➢ Procurement Requisition/Approval   ➢ Receipt of Goods
    ➢ Purchase Order Issuance   ➢ Accounts Payable/Payment Disbursement

    Based on a review of changes made to these security groups, all previously noted access security issues appear to have been resolved. In particular, accounts payable representatives are no longer able to enter procurement requisitions or receipts. Further, according to staff, some Purchasing staff's (i.e. PURCH group) ability to enter receipts must remain so that change orders can be appropriately processed.

Duplicate Payment Controls Need Improvement

3. **Include a standard invoice numbering guideline within the policies and procedures manual.**

    Management Response: Concur
    <u>Finance Comments</u>: The standard invoice numbering practice will be incorporated in the updated Policy Manual.

    Audit Follow-Up Finding: Implemented
    The Accounts Payable Division adopted written guidance for staff on how to process vouchers without unique invoices numbers in September 2023. This guidance generally covers all instances where a voucher may not have a unique invoice number. It should be noted that this guidance may result in some unique vouchers being processed with the same "invoice number" based on this guidance.

4. **Consider developing a procedure to verify that certain invoices have not already been paid on a procurement card.**

    Management Response: Concur
    <u>Finance Comments:</u> Staff has been exploring ways to compare invoices paid by p-cards to invoices processed thru the Accounts Payable system. The only common data between the two systems is the date of the transaction and the amount. The P-card system does not use the Vendor Master numbering system and the transaction number on the receipt is not in the JDE system. We are currently installing a new travel and p-card software which should enhance shared between the two systems to find data points that we can use to search for duplicate transactions. Ultimately, the payments are from separate systems and staff will implement all procedures policy to mitigate the risk.

    Audit Follow-Up Finding: Implemented
    The City has contracted with it's p-card monitoring vendor to perform a comparison of all p-card purchases and previous payments with payments issued each week. The vendor then produces a comparison report highlighting potential duplicates by risk level. This report is reviewed by Accounts Payable staff each week, helping to reduce the risk that invoices are not also being paid on p-card. It should be noted that reviews of this comparison report are currently being documented via e-mail. Documentation of these reviews could be improved by utilizing the provided report form and saved in a central location.

Some Exempted Taxes Have Been Paid

5.   **Establish a process to ensure the City is not paying any taxes for which it is exempt.**

Management Response: Concur

<u>Finance Comments</u>: Accounting staff is consistently being reminded to check for sales taxes being billed on vendor invoices while reviewing the Accounts Payable check run.[1] Also, Accounts Payable staff has the responsibility to reduce any sales tax charges and file the proper work with the vendor to exempt any future sales tax charges. These practices will be incorporated into the updated Policy and Procedures Manual.

Audit Follow-Up Finding: Implemented

According to Finance staff, Accounts Payable manually verifies that invoices received do not include exempt taxes as part of their standard review process. If exempted taxes are included, the amount is deducted from the issued check and the vendor is notified of the City's exempt status. Based on a sample review of 95 payments, no exempt taxes were paid.

Receiving Documentation Can be Improved

6.   **Require employees to enter adequate receiving documentation for all goods and services.**

Management Response: Concur

<u>Finance Comments</u>: As Part of the update to the Accounts Payable Policy and Procedures manual, we will require the department personnel to upload an image of the receiving or shipping document with the invoice as a reference for City staff when processing payments to the vendor.

Audit Follow-Up Finding: Implemented

The Cash Disbursements policy, implemented in January 2021, states "appropriate documentation to support expenditures is the detailed, itemized original 'invoice' or receipt listing the items purchased." This policy clarifies what is considered adequate receiving documentation for goods and services. This standard was not previously set.

Based on a sample review of 95 payments issued during calendar year 2020, only one appeared to have receiving documentation that may be inadequate. In addition, based on this review, more purchase orders for

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[1] According to Finance management, the practice where Accounting staff review checks issued by Accounts Payable valued over $5,000 was discontinued in 2023.

goods appeared to use a quantity and price order method instead of a lump sum. The quantity and price order methodology for purchase orders provides further assurance that goods are received before payment because staff entering the receiver must enter the quantity of the goods received instead of just the invoiced cost.

7. **Consider requiring the employee who physically receives goods or services to enter the receiving document in JD Edwards via policy.**

    Management Response: Concur
    Finance Comments: Agree. As part of the update to the Accounts Payable Policy and Procedures manual, we will require the department personnel to upload an image of the receiving or shipping document with the invoice as a reference for City staff when processing payments to the vendor.

    Audit Follow-Up Finding: Implemented
    The new Cash Disbursements policy, implemented in January 2021, requires employees to "obtain detailed, itemized transaction documentation for all purchases, review and verify the validity of all transactions, reconcile transaction to documentation, indicate proper general ledger account coding for transactions and submit required records to the Approver." This new policy appears to place the responsibility for ensuring all goods and services are appropriately received on the employee making the purchase, while still giving departments the flexibility to centralize receiver input.

    Based on discussions with Finance staff, many functions centralize receiver input responsibilities. While these responsibilities could be decentralized, it would likely require additional expansion of infrastructure to allow most employees to be able to enter receivers. Specifically, additional financial system users would need to be created and monitored and additional computers may need to be purchased to allow employees to log in and enter the receivers. For this reason, the City has accepted the risks associated with centralized receiver input for operational efficiency reasons.

Some Check Requisition and Dispersal Practices are Inappropriate

8. **Require check requisitions under $5,000 to be approved by a supervisor.**

    Management Response: Concur
    Finance Comments: We will distribute new forms requiring the Supervisor or Manager of the person submitting the check requisition to approve the

under $5,000 purchase. Directors already are required to approve any check requisition over $5,000.

Audit Follow-Up Finding: Implemented

The Cash Disbursements policy, implemented in January 2021, requires that check requisitions under $5,000 be approved by a supervisor. In addition, based on a review of 96 sample payments issued between August 2022 and July 2023, nine were vouchered by a check requisition. Of these, all were appropriately reviewed and approved.

9. **Restrict physical collection of checks.**

Management Response: Concur

Finance Comments: All Vendor checks will be mailed in the future. We will inform our vendors and City staff that we will no longer release check payments. We will encourage our vendors to choose ACH payments as an alternative. Exceptions to this policy will be allowed on a case by case basis.

Audit Follow-Up Finding: Implemented

The Cash Disbursements policy, implemented in January 2021, states "with very limited exceptions, all checks are to be mailed- there are no vendor pickups. Exceptions, which can be picked up by City employees only, include legal settlements, property purchases, grants, or special requests."

Based on a review of Accounts Payable's Check Pickup log, about 1% of issued checks were physically picked up between October and December 2020. Of these, no checks were picked up by a vendor and all pickups appeared to have generally complied with the Cash Disbursements policy. Table 3 below summarizes these picked up checks:

Table 3: Check Pickups (Oct. 2020 – Dec. 2020)

Pickup Dept.	Checks	Value	Pickup Dept.	Checks	Value
Finance	3	$1,894,893.56	Parks	3	$7,463.75
Facilities	1	$179,429.96	Legal	2	$1,065.30
Real Estate	5	$45,449.05	Water	1	$285.96
Electric	1	$12,500.00	All:	16	$2,141,087.58

10. **Encourage the use of electronic payments instead of paper checks where possible.**

Management Response: Concur

Finance Comments: Agree. The Procurement Office is responsible for setting up the Vendor Masters, including the method of payment the Vendor chooses. We also follow up with reviews of vendor payment

registers to look for and request vendors to setup ACH Payments to eliminate the need for paper checks.

Audit Follow-Up Finding: In Progress

The Cash Disbursements policy, implemented in January 2021, does not include a requirement or preference for vendors to receive electronic payments. In addition, Finance and Procurement staff stated that they had not initiated any efforts since the issuance of the original audit to proactively encourage vendors to convert to electronic payments. Table 4 below shows that there has been a percent increase in the number of electronic payments processed compared to the original audit; however, this increase does not appear to be significant.

Table 4: Electronic Payment Comparison

	FY 2018	CY 2020	Aug. 2022 - Jul. 2023
Number of Electronic Payments	4,177	3,744	4,398
"Eligible" Payments[2]	9,819	8,123	9,632
Percent of "Eligible" Payments	43%	46%	46%
Percent of All Payments	30%	34%	35%

According to Finance staff, there has not been a concerted effort to encourage vendors to switch to an electronic payment method due to operational roadblocks. Staff stated that they may begin trying to further encourage this once the new vendor management portal has been rolled out by the Procurement Department and the distribution of electronic payment remittance advices has been automated.

Staples Advantage Features are not Adequately Utilized

11. **Develop a process to ensure Staples Advantage purchases are properly approved and received.**

    Management Response: Concur
    Finance Comments: All Staples invoices should include a PO number so that the purchases are authorized by department management and we can process the payment using the Accounts Payable system to match the PO and receiver against the invoice amounts. We are anticipating adding software that will automate the processing of invoices received from our vendors. Using PO number on the Staples purchase will leverage

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[2] According to Finance staff, only vendors who receive more than one payment are eligible to be paid electronically. For that reason, vendors who only received one payment via check were excluded from this calculation.

the automation and speed the process of paying all of our vendor invoices including Staples.

Audit Follow-Up Finding: Implemented
Since the original audit, Procurement has worked with City departments to set up approval workflows in the Staples Advantage system. Through this system, users are either classified as associates who order items or supervisors who are able to approve item purchases. Based on review of an August 2023 Staples Advantage User Report, all of the City's 98 Associate users had an appropriate approval workflow setup. In addition, all 75 Supervisor accounts were blocked from making purchases.

It should be noted that about 16 employees had both an Associate and a Supervisor account; however, these all appeared to have an appropriate supervisor account setup.

12. **Annually review Staples Advantage users to verify that access is still appropriate.**

    Management Response: Concur
    Purchasing Comments: The control of access to the Staples Advantage is with the Procurement Office. The Purchasing Office will request a user list from Staples annually or however frequently, as needed. Purchasing will send the list out to the departments to verify the users and ask Staples to make the requested changes.

    Finance Comments: We agree that an annual review of city staff access to order from Staples should be performed to maintain the proper access of personnel and will be incorporated into the updated Policy and Procedures Manual.

    Audit Follow-Up Finding: Implemented
    According to Procurement staff, they have set up an annual review process where departments are asked to confirm that their users still need access. In addition, Procurement staff have implemented several user access review processes, including a quarterly review and verification of the user report, and a weekly review to ensure employees who have recently separated from the City no longer have access to the system.

    Of all 173 users, only two (about one percent) appeared to no longer be active employees. Both of these users appeared to be Supervisor accounts who could not make purchases. Further, both of these accounts appeared to be for employees who appeared to also have an Associate account, indicating that while user access management is generally effective, Procurement staff should verify that users do not have two accounts when removing access.

13. **Consider changing current Staples Advantage billing practices to improve efficiency in the Accounts Payable Division.**

Management Response: Partially Concur

Finance Comments: We are anticipating adding software that will automate the processing of invoices receiver form out vendors. This will speed the process of paying all of our vendor invoices including Staples. Having a PO number on the invoice is key to the automation process. We will change our procedures to effectively leverage the ability of the software to scan and voucher a vendor's invoice to make the payment process more efficient.

Purchasing Comments: We do not have the ability to change Staples' billing practices or procedures. We can limit the number of City staff that have access to order from Staples and agree that this should be reviewed annually to ensure the proper employees have access.

Audit Follow-Up Finding: Implemented

This City has changed its billing method with Staples so that it receives an invoice for each <u>order</u> placed instead of each <u>delivery</u>. This has reduced the number of invoices received from Staples annually by about 98 percent. Between August 2022 and July 2023, about 0.2 percent of the City's vouchers were for Staples compared to 6.3 percent during the previous audit. In addition, Staples payments represented about 0.04 percent of the total amount disbursed between August 2022 and July 2023, compared to 0.06 percent from the original audit.

Table 5: Staples Billing Practices Change Comparison

	Vouchers	Voucher %	Disbursed	Disbursed %
Fiscal Year 2018	3,072	6.3%	$339,546	0.06%
Aug. 22- Jul. 23	55	0.2%	$296,057	0.04%

Audit Project Background

The City Auditor's Office is responsible for providing: (a) an independent appraisal[3] of City operations to ensure policies and procedures are in place and complied with, inclusive of purchasing and contracting; (b) information that is accurate and reliable; (c) assurance that assets are properly recorded and safeguarded; (d) assurance that risks are identified and minimized; and (e) assurance that resources are used economically and efficiently and that the City's objectives are being achieved.

Auditing Standards

We conducted this performance audit 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.

Management Responsibility

City management is responsible for ensuring that resources are managed properly and used in compliance with laws and regulations; programs are achieving their objectives; and services are being provided efficiently, effectively, and economically.

Objectives, Scope, and Methodology

The City Auditor's Office has completed a second follow-up review of the Audit of Accounts Payable, which evaluated the effectiveness of controls over accounts payable in order to properly record and safeguard the spending of municipal funds. This report is intended to provide a progress update on recommendations from the Audit of Accounts Payable originally issued in October 2019 that were still outstanding after the initial Audit of Accounts Payable: Follow-Up Report published in March 2021.

Audit fieldwork was conducted during July and August 2023. The review scope varied depending on the procedure being performed. The following list summarizes major procedures performed during this time:

- ➢ Reviewed documentation from the issued audit to develop criteria including industry standards, best practices, policies, and procedures;

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[3] The City of Denton's City Auditor's Office is considered structurally independent as defined by generally accepted government auditing standard 3.56.

➢ Interviewed City of Denton Finance Department, Procurement Department, and Technology Services Department staff;

➢ Reviewed new and updated policies and standard operating procedures;

➢ Analyzed payments vouchered and payments disbursed between August 2022 and July 2023;

➢ Examined supporting documentation for a randomly selected statistical sample of 96 payments issued between August 2022 and July 2023;[4] and

➢ Inspected user access reports for the City's financial system and Staples Advantage account.

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[4] This sample size provides 95 percent confidence that the true population is within ±10 percent of the sample estimate.

City of Denton

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Denton, Texas 76201
www.cityofdenton.com

Legislation Text

File #: IAAC24-011, **Version:** 1

AGENDA CAPTION

Receive a report, hold a discussion, and take necessary action regarding the completion and closure of Audit Project 010 - Capital Projects Administration: Property Acquisition.

City of Denton

City Hall
215 E. McKinney Street
Denton, Texas
www.cityofdenton.com

AGENDA INFORMATION SHEET

DEPARTMENT: **City Auditor's Office**

CITY AUDITOR: **Madison Rorschach**

DATE: **April 29, 2024**

SUBJECT
Receive a report, hold a discussion, and take necessary action regarding the completion and closure of Audit Project 010 – Capital Projects Administration: Property Acquisition.

BACKGROUND
In accordance with the City of Denton Ordinance 21-2035, the Internal Audit Advisory Committee is responsible for providing oversight of the internal audit function, including monitoring follow-up on reported findings to assure corrective action is taken by management.

DISCUSSION
An audit project of the City's property acquisition process for capital improvement projects was originally conducted and reported to the City Council in May 2020. This audit identified a few risks including missing documentation of critical property acquisition steps such as appraisal reports, initial and final offer letters, and title commitments, and a lack of defined authority levels for property negotiation.

Since the issuance of this audit, several improvements have been made to the City's procurement process including:

- Implementation of procedures that outline the negotiation process for acquiring real estate assets and reporting these to the Accounting Division;

- Establishment of minimum requirements for hired property appraisers; and

- Establishment of clear requirements for Real Estate staff to receive adequate training.

Internal Audit generally evaluated these process improvements as part of the April 2022 and July 2023 follow-up reviews and believes that these improvements adequately address the recommendations issued as part of the original Audit of Capital Projects Administration: Property Acquisition.

RECOMMENDATION
Staff recommends approval of the attached Audit Project Completion Form and final closure of Audit Project 010 – Capital Projects Administration: Property Acquisition. These processes will continue to be considered for review annually as part of the Annual Internal Audit Plan development process.

PRIOR ACTION/REVIEW (Council, Boards, Commissions)
Mar. 17, 2020: Audit/Finance Committee recommended forwarding the Audit to City Council

May 12, 2020: Audit of Capital Projects Administration presented, and Project 010 closed till follow-up by Council

Apr. 5, 2022: Audit of Capital Projects Administration: Property Acquisition Follow-Up Review presented, and Project 010 closed till informal follow-up review by Council

Jul. 21, 2023: Fiscal Year 2022-23 Informal Follow-Up Review distributed to City Council via the Friday Report – included information on Project 010

EXHIBITS
1. Agenda Information Sheet
2. Audit Project Completion Form – 010 Capital Projects Administration: Property Acquisition
3. Audit of Capital Projects Administration: Property Acquisition
4. Audit of Capital Projects Administration: Property Acquisition Follow-Up Review

Respectfully submitted:
Madison Rorschach, 940-349-7228
City Auditor

Audit Project Completion Form

Project Title: Capital Projects Administration: Property Acquisition   Project Number: 010

Table 1: Project Timeline

Deliverable	Responsible Staff	Audit Plan FY	Date Issued	Months to Complete	Hours to Complete
Audit Report	Neeraj Sama Umesh Dalal	FY2018-19	05/12/2020	12.00	NA
Follow-Up Report	Madison Rorschach Neeraj Sama	FY2021-22	04/05/2022	2.25	NA
Informal Follow-Up Report	Madison Rorschach Jenesa Halter	FY2022-23	07/21/2023	NA	6.25
			Total:	**14.25**	**6.25**

Concurment Rate: 100%   Implementation Rate: 100%

Table 2: Project Recommendation Summary

Recommendation	Mgmt. Response	Status
1. Require Real Estate Staff to execute and maintain all required documents properly for acquisition of real estate properties in line with implemented real estate acquisition process.	Concur	Implemented

2. Adopt a formalize negotiation process incorporating the following key requirements:
  a. Criteria and steps of negotiation with the property owner including a requirement to perform in-depth interviews with property owners to discuss issues such as the impact of the project, property usage by the owner, and estimated value of the property;
  b. Real Estate staff get approval of the Deputy Director on a formal document recording the agreement on settlement price along with the justification for accepting the price over and above the appraisal value; and
  c. Limitation on the power of Real Estate Specialists to independently negotiate up to a certain percentage of appraised value and involvement of senior officials beyond that limit.
	Concur	Implemented

3. Jointly develop a process with the Accounting Division for timely reporting of donated real estate assets to improve recordkeeping.	Concur	Implemented

4.	Define qualification criteria in policies and procedures for hiring and engaging appraisers.	Concur	Implemented
5.	Codify Real Estate Specialist training requirements to provide greater assurance that staff is constantly abreast of updated laws and procedures relating to acquisitions.	Concur	Implemented

Based on the project timeline and recommendation summary listed previously, the City Auditor recommends this project be closed and considered formally complete:

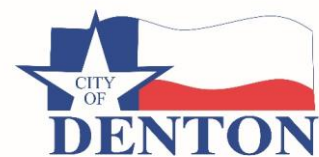City Auditor: _Madison Rorschach_   Date: _07/31/2023_

AUDIT OF CAPITAL
PROJECTS ADMINISTRATION

Property Acquisition

ABSTRACT

The Real Estate Division's acquisition procedures are generally adequate. Improvement in controls over acquisition activities will improve the effectiveness of transactions.

City Auditor's Office

Table of Contents

Executive Summary

Honorable Mayor and members of the City Council,

The City Auditor's Office has completed a performance audit of the Real Estate Division's property acquisition process for capital projects. The City of Denton's Real Estate Division (Division) acts as a service division for other departments and provides real estate services, including property acquisition, property valuation, relocation, and other property related services. The Division also acquires rights of way for City departments constructing capital projects, and as part of those services.

The following are our salient findings:

- The Real Estate Division's records were missing in a few tested samples as presented in Table 3, which bears the risk of hindering management verification of accuracy and appropriateness of transactions. Any abuses of the process may not be identified if relevant documentation is missing. That being said, the acquisitions were properly recorded in the County's records transferring title to the City.

- Current acquisition procedures do not specify a negotiation authority level for Real Estate Specialists. Such a delegation of authority would typically set a certain limit or percentage over the appraisal value of the property that the Specialist can offer without further documentation. In the absence of proper formal documentation recording the negotiation proceedings and justification for outcome, effectiveness of the negotiation efforts during the selected acquisitions could not be verified. Due to this reason, it is not clear if the agreed final settlement price was justified. This condition may lead to abuses. No formal document was available that could provide justification for the agreed settlement prices for 18 out of 20 parcels that were acquired above appraised value.

Management has concurred with 5 of 5 recommendations made in this report. Management responses are attached to this report in Appendix A. We appreciate staff's cooperation during the audit. Please contact the City Auditor if you have any questions or need more information.

Sincerely,

Umesh Dalal, City Auditor

Introduction

The City Auditor is responsible for providing: (a) an independent appraisal[1] of City operations to ensure policies and procedures are in place and complied with, inclusive of purchasing and contracting; (b) information that is accurate and reliable; (c) assurance that assets are properly recorded and safeguarded; (d) assurance that risks are identified and minimized; and (e) assurance that resources are used economically and efficiently and that the City's objectives are being achieved.

The City Auditor's Office has completed a performance audit of the real estate acquisition process of the Real Estate Division as part of the Capital Projects audit. We conducted this performance audit in accordance with generally accepted government auditing standards with the exception of standard 4.18 regarding documentation of audit staff's continuing professional education.[2] 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.

Management Responsibility

City management is responsible for ensuring: resources are managed properly and used in compliance with laws and regulations; programs are achieving their objectives; and services are being provided efficiently, effectively, and economically.

Audit Objectives, Scope, and Methodology

This report is intended to provide assurance about economic and efficient use of the City's resources by evaluating the effectiveness of controls over the Real Estate Division's property acquisition process for capital projects.

Audit fieldwork was conducted during September and October of 2019. The scope of review varied depending on the procedure being performed. The following list summarizes major procedures performed during this time:

- Reviewed documentation including industry standards, best practices, policies, and procedures;

- Developed a process narrative and flow chart to identify current control activities, which was certified by the Capital Projects Deputy Director of Real Estate;

- Reviewed a sample of 30 right of way acquisitions (41 parcels) out of a population of 77 property parcels valued around $2.7 million acquired by The Real Estate Division for Capital Projects during 2018 and 2019. The acquisitions completed during this period consist of different parcel types, viz. fee simple[3] (11), permanent easement[4] (23), temporary easement (40) and right of way[5] (3). To review the property acquisition activities of the Real Estate Division relating to capital projects, 30 acquisitions samples (41 parcels) out of a population of 64 acquisitions (77 parcels) were selected.

[1] The City of Denton Internal Auditor's Office is considered structurally independent as defined by generally accepted government auditing standard 3.56.
[2] This report was amended on February 15, 2022 to disclose this exception, the details of which were communicated to the City Council in a Staff Report publicly issued on February 11, 2022.
[3] Land owned in fee simple is owned completely, without any limitations or conditions.
[4] An easement is a legal right to use another's land for a specific limited purpose.
[5] A right of way (ROW) is a right to make a way over a piece of land, usually to and from another piece of land.

These consisted of fee simple (10), permanent easement (16), temporary easement (13) and right of way (2). Since the selected sample spread over two administrations, Table 1 provides context to our observations:

Table 1: Sample Parcels Completed prior to / during or after February 2017

Administration	Acquisition Began	Parcels Acquired
Prior Administration*	Prior to February 2017	14
Current Administration*	During or After February 2017	27
	Total:	41

Prior Administration and Current Administration have been referred to the previous City Manager's and current City Manager's administration respectively.

The City acquires real estate through purchase, eminent domain, exchange or by donation. The acquisition samples selected for audit represent all kinds of acquisitions as presented in Table 2.

Table 2: Selected Samples' Mode of Acquisition

Mode of Acquisition	No. of Parcels
Purchase	26
Eminent Domain[6]	11[7]
Donation	3
Exchange	1
Total:	41

- Compared the Real Estate Division's acquisition procedures to the Texas Property Code, Texas Local Government Code and other laws as applicable, and

- Interviewed Real Estate Division staff to better understand the acquisition process and activities undertaken

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[6] Eminent domain is the government's power to take private land for public use under certain circumstances.

[7] 11 parcels were acquired from 2 property owners.

What Works Well

The City of Denton's Real Estate Division (Division) acts as a service division for other departments and provides real estate services, including property acquisition, property valuation, relocation, and other property related services. The Division also acquires rights of way for City departments constructing capital projects, and as part of those services, performs the following activities:

➢ Work closely with real estate consultants, title companies and appraisers;

➢ Order title reports and property appraisals;

➢ Meet with property owners;

➢ Present offers; and

➢ Negotiate property sales transactions, including requesting City Council's approval for real estate transactions, whenever required.

Real Estate's Current Acquisition Procedures Align with Applicable Laws

The auditors reviewed the existing procedures followed by the Real Estate Division for acquisition of properties and found that:

- The current acquisition procedures followed by Real Estate has been established in compliance with the Texas Property Code (Chapter 21) and the Texas Local Government Code (Chapters 251 & 252.051), wherever applicable.

  o Established procedures require an appraisal to be ordered whenever the acquisition of any property is initiated.

  o The timelines and documentary requirements of the established procedures have been framed in accordance with the requirements of aforementioned laws.

- In case of all acquisitions, wherever the power of eminent domain was used, the condemnation process was properly administered and completed under applicable provisions of the Texas Property Code (Chapter 21) and the Texas Local Government Code (Chapters 251 & 252.051) with appropriate approval of City Council.

- The requirement for Uniform Relocation Assistance (Texas Property Code § 21.046) and assessment under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 are duly incorporated in the acquisition procedures checklist.

Management Reporting and Tracking Procedures have Improved

A construction project's timeline depends upon the timely acquisition of the relevant properties identified during the design phase. Though the time taken in acquisitions may depend on various factors such as negotiations, re-designing, funding, re-prioritizations, occupant relocations, discovery of additional interests, and staffing shortages, proper tracking helps to improve the efficiency of staff and control of management over the overall process. Additionally, two-way communication between the Real Estate Staff and Project Managers is required to ensure that project delays are avoided as much as possible. Without timely communication of delays and real-time status updates, Project Managers may not be able to adequately plan for the completion of their projects.

Therefore, it is critical that periodically Project Managers receive acquisition tracking and status reports. The auditors found the following:

- No formalized procedure existed prior to February 2019 for sharing parcel acquisition tracking and status reports with Capital Project's Project Managers.

- However, as a result of new Real Estate management's observations and actions, tools are being implemented to improve and standardize the tracking and reporting of Real Estate acquisition activities, including:

  o Real Estate maintains a "Monthly Status Tracking Report" to track the status of open acquisition cases in EXCEL. While the report is required to be updated on a real-time basis by Real Estate staff, it does not currently contain information on all historical projects; however, Real Estate is working on inputting all historical project information into this database in an effort to streamline reporting procedures.

  o Real Estate has implemented a new spreadsheet-based "Progress Report" for milestones tracking with Project Managers.

  o Finally, Real Estate staff and Project Managers communicate frequently via email and telephone as the acquisition progresses or when there is a potential delay.

Opportunities for Improvement

Acquisition activities of the Real Estate Division of the City of Denton are governed by the Texas Property Code, Texas Local Government Code and City Ordinances as applicable. The City must have adequate evidence of compliance with the statutory provisions.

Acquisition Process Documentation Needs to be Improved

Formally adopted policy documents help eliminate common misunderstandings by recognizing job responsibilities, establishing limitations for the job holders and achieving a common business objective. The steps of the real estate acquisition process were established in February 2019 and their associated documentation are depicted in Figure 1:

Figure 1: Real Estate Acquisition Process
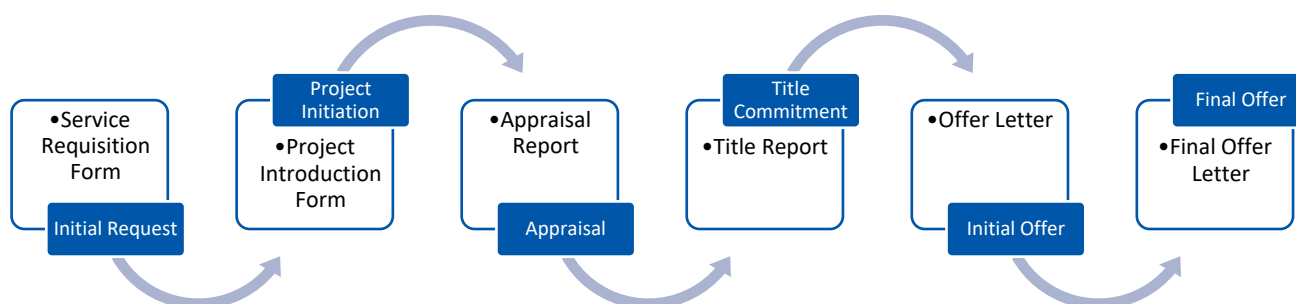
What We Found?

Based on the testing of the selected parcels, we found that the required documents were not properly maintained or executed as follows in Table 3:

Table 3: Missing Documents

Documents	Missing Documents			
	Prior Administration (14 parcels)		Current Administration (27 parcels)	
	# of Parcels	%	# of Parcels	%
Services Requisition Form[8]	NA	NA	3*	75.0%
Project Introduction Letter[9]	NA	NA	4*	100.0%
Appraisal Report	2	14.3%	3	11.1%
Title Commitment	0	-	1	3.7%
Initial Offer Letter	0	-	1	3.7%
Final Offer Letter/ Letter of Understanding (LOU)	0	-	2	7.4%

*Only 4 acquisitions were started and completed after Feb 2019.

- In two (2) cases, the initial offer letters were signed by Real Estate staff and not by the City Manager; Real Estate staff did not have authority to sign offer letters at that time.

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[8] Introduced in the February 2019 formal procedures.

[9] Introduced in the February 2019 formal procedures.

- o Deputy Director of Real Estate has been authorized by City Manager to make offer and negotiate the real estate property acquisition up to a value of $50,000 effective July 31, 2019.

- We were able to verify that:

  - o The selected acquisitions were properly recorded with the Denton Central Appraisal office and recorded instruments were available. All selected final acquisitions were completed with the appropriate authority of City Manager and City Council approval whenever required and ordinances were properly passed.

  - o Other requirements of the Texas Property Code, the Texas Local Government Code, the Uniform Relocation Assistance (Texas Property Code § 21.046) and the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 have been duly complied with, wherever applicable.

- Auditors also recognized that Real Estate acquisition procedures have improved under current Real Estate management's guidance and leadership. Real Estate is in the process of implementing Standard Operating Procedures (SOP) as a guidance to other functions to understand and follow the requirements while requesting any property acquisition.

Why Does It Matter?

The Real Estate Division's records were missing in a few tested samples as presented in Table 3, which bears the risk of hindering management verification of accuracy and appropriateness of transactions. Any abuses of the process may not be identified if relevant documentation is missing. That being said, the acquisitions were properly recorded in the County's records transferring title to the City. The following are the implications of the above observations:

- In the absence of Services Requisition Forms, it is difficult to verify the timeliness of an acquisition request as well as the exact details of parcels and properties requested for acquisition. According to the Deputy Director of Real Estate, an acquisition request should ideally be received from Project Managers when about 30% of project design is completed and parcels are identified for acquisition. This timeframe typically provides adequate opportunity to complete the acquisition process, however, if project redesigns occur, it may cause delays to the construction project. In addition, it may be difficult to prioritize acquisition projects without tracking which department has authorized and for what reason a project was initiated.

- Acquisition activities start with sending a Project Introduction Letter to the owners of the properties to be acquired. This requirement aligns with the industry's best practices. This letter is sent to inform property owners in advance about public projects before the initiation of acquisition activities. Absence of advance project intimation could surprise the property owners and may or may not impact their willingness to work with the City. These events may delay the acquisition process.

- Missing appraisal reports may result in non-compliance with Chapter 252.051 of Texas Local Government Code. In addition, the City may not know the actual worth of the property to be acquired and could end up in paying higher settlement price of the property even after negotiation.

- Title commitments indicate if the property has clear title or defects to the title. Without these documents, it may not be possible to determine if the City will receive free and clear title to the property being acquired.

- Documents such as initial and final offer letters represent the City's terms of acquisition of the property. When an initial offer letter results in further negotiation, a final offer letter or a letter of understanding should be executed to document the agreed upon terms for proper recording of the transaction.

- Unauthorized execution of documents by City staff on the City's behalf bears an inherent risk of abuse and fraud, though none was identified.

Recommendations:

1. Require Real Estate Staff to execute and maintain all required documents properly for acquisition of real estate properties in line with implemented real estate acquisition process.

   Real Estate Comments: Direction to execute and maintain documents had previously been given prior to audit. Steps have been implemented to check/confirm compliance monthly.

Negotiation Process is not Formalized

Real Estate makes offers to property owners for acquisition of real estate properties and parcels. In cases where negotiations with the property owners do not work out, condemnation proceedings typically follow as shown in Figure 3. While project plans, surveys, and construction have relatively finite timelines, condemnation proceedings often make property acquisition last longer than expected or desired.[10] A streamlined, and formalized negotiation process would help Real Estate staff steer negotiation activities in a systematic manner.

Figure 3: Negotiation and Eminent Domain Process

Process of negotiation with the property owner
Present the offer, initiate contract negotiation, present final offer, conduct settlement, documentation and transaction closure
(Expected completion Timeline of 4 - 5 months)

Owner Declines Offers

Eminent Domain (Condemnation Process) *
Real Estate requests the City Council's approval and subsequently the City Attorney's Office handles relevant legal proceedings under the condemnation process.
(Expected completion timeline of 8 - 11 months)
* Government's power to take private land for public use

Effects on the Project

Potential increases in land values and construction cost and project schedule delays

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[10] National Cooperative Highway Research Program (NCHRP) Study 2000.

What We Found?

- As per current procedures, a Real Estate Specialist negotiates with the property owner in good faith to reach an agreed price through correspondence, calls, and potentially visit unresponsive property owners whenever necessary.

- Current acquisition procedures do not specify a negotiation authority level for Real Estate Specialists. Such a delegation of authority would typically set a certain limit or percentage over the appraisal value of the property that the Specialist can offer without further documentation.

- Current acquisitions procedures do not prescribe any form for documenting the justification and agreement on the final settlement price over and above the appraisal value.

  - No formal document was available that could provide justification for the agreed settlement prices for 18 out of 20 parcels (20 parcels were acquired at a settlement price over the appraisal value, which constitute 49% of total parcels reviewed).

Why Does It Matter?

Negotiation is a vital phase in the overall right of way acquisition process. If not administered properly through a formal process, negotiation proceedings may increase acquisition cost and delay the overall project as well. Best practices in the "TxDOT Guidebook for Right-of-Way Valuations and Negotiations" affirm that successful negotiations can benefit the City by reflecting fair market prices, building a good rapport with landowners, and reducing project duration and cost. Negotiation outcomes can be made more effective by having in-depth interviews with the property owner regarding the project and property.

In the absence of proper formal documentation recording the negotiation proceedings and justification for outcome, effectiveness of the negotiation efforts during the selected acquisitions could not be verified. Due to this reason, it is not clear if the agreed final settlement price was justified. In addition, current procedures authorize Real Estate Specialists to negotiate with the property owner whenever required without involvement of senior Real Estate personnel. There is no limitation established on the ability of a Real Estate Specialist to independently negotiate acquisition price. Unrestricted powers of negotiations for Real Estate Specialists may lead to a closure of negotiation proceedings at higher settlement prices and may increase acquisition cost. In addition, this condition may lead to abuses.

Recommendations:

2. Adopt a formalized negotiation process incorporating the following key requirements:

   a) Criteria and steps of negotiation with the property owner including a requirement to perform in-depth interviews with property owners to discuss issues such as the impact of the project, property usage by the owner and estimated value of the property;

   b) Real Estate staff to get approval of the Deputy Director on a formal document recording the agreement on settlement price along with the justification for accepting the price over and above the appraisal value; and

   c) Limitation on the power of Real Estate Specialists to independently negotiate up to a certain percentage of appraised value and involvement of senior officials beyond that limit.

   Real Estate Comments: Processes for each recommendation were in place at time of audit. Formal adoption has been completed through the department's SOP process.

Information about Donated Properties is not Communicated to Accounting

Statement 34 of the Governmental Accounting Standards Board states that "donated capital assets should be reported at their estimated fair value at the time of acquisition." Capital assets include permanent easements.

What We Found?

- Real Estate does not have an established process for reporting donated properties and parcels to the Accounting Division for recordkeeping.

- Of the 41 parcels reviewed, 3 permanent easement parcels were donated to the City. These parcels were not reported to the Accounting Division and were not documented in the City's financial records.

Why Does It Matter?

Capital asset value in the City's financial statements is understated at least by $71,591 (the appraised value for one parcel is not known, hence excluded from this amount).

Recommendations:

3. Jointly develop a process with the Accounting Division for timely reporting of donated real estate assets to improve recordkeeping.

    Real Estate Comments: Process has been implemented and monthly reporting has been established.

Real Estate Policy Changes Should be Made to Align with Best Practices

Auditors found that the following best practices recommended in the "TxDOT Guidebook for Right-of-Way Valuations and Negotiations" can improve current real estate acquisition process.

➢ Appraisers hired must be state-certified or licensed by the Texas Appraiser Licensing and Certification Board.

➢ Real Estate Division staff should periodically attend training courses to ensure their understanding of laws and procedures relating to acquisitions.

These practices were developed and compiled by Center for Transportation Research Department of University of Texas, Austin based on review of statutes and analysis of surveys and interviews of property owners and TxDOT personnel.

What We Found?

- Current Acquisition procedures followed by the Real Estate Division do not prescribe any qualification for appraisers to be hired. However, we found the following practices:

  o State Certified Appraisers were hired in all sample cases where appraisal reports were available.[11] Additionally, 22, appointed appraisers were also a Member of Appraisal Institute (MAI).

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[11] Appraisal reports were not available in 5 sample parcels.

- o Auditors were informed that Member of Appraisal Institute (MAI) are hired as appraisers when possible.

- Current acquisition procedures followed by the Real Estate Division do not prescribe any staff training requirements.

  - o Auditors were informed during the interview with Real Estate Division's staff that training, and seminars organized by the International Right of Way Association are attended by some staff members of the Real Estate Division to maintain Continued Professional Education (CPE) requirements of their licenses.

Why Does It Matter?

According to the TxDOT, professionally qualified appraisers will have significant experience in applying the generally recognized valuation methods and techniques. These appraisers are bound to follow the code of ethics of their institution and are expected to generate unbiased, independent and objective appraisal reports. Auditors recognize the best practices followed by Real Estate by appointing state-certified appraisers, though the requirement is not codified in the current procedures. Codifying this requirement would further obligate the current and future staff to follow the practice.

Requiring Real Estate staff to undergo periodic training would improve overall staff expertise. It would provide assurance for completing the title commitment, appraisal and uniform relocation assistance activities in a proper manner in conformance with updated laws. One NCHRP study (NCHRP, 2000) reported that inadequately trained staff presents one of the biggest challenges to reducing the project delivery time.

Recommendations:

4. Define qualification criteria in policies and procedures for hiring and engaging appraisers

   Real Estate Comments: Currently advertising RFQ to define and establish criteria.

5. Codify Real Estate Specialist training requirements to provide greater assurance that staff is constantly abreast of updated laws and procedures relating to acquisitions.

   Real Estate Comments: Licensed Real Estate Specialists have required continuing education to maintain licensure. Additionally, industry training is offered, recommended and required as appropriate, when applicable to legal updates impacting eminent domain acquisition processes.

Appendix A: Management Response Matrix

The following summarizes the recommendations issued throughout this report. The auditors found that staff and the Division was receptive and willing to make improvements to controls where needed. Management has provided their response to each recommendation.

1	*Require Real Estate Staff to execute and maintain all required documents properly for acquisition of real estate properties in line with implemented real estate acquisition process*	**Concur**	Expected Completion: **Complete**
	Comments: Direction to execute and maintain documents had previously been given prior to audit. Steps have been implemented to check/confirm compliance monthly.		**Responsibility:** Dep. Dir. Of CP-RE/RE Prog. Mgr.
2	*Adopt a formalized negotiation process incorporating the following key requirements:* a) *Criteria and steps of negotiation with the property owner including a requirement to perform in-depth interviews with property owners to discuss issues such as the impact of the project, property usage by the owner and estimated value of the property;* b) *Real Estate staff to get approval of the Deputy Director on a formal document recording the agreement on settlement price along with the justification for accepting the price over and above the appraisal value; and* c) *Limitation on the power of Real Estate Specialists to independently negotiate up to a certain percentage of appraised value and involvement of senior officials beyond that limit.*	**Concur**	Expected Completion: **Complete**
	Comments: Processes for each recommendation were in place at time of audit. Formal adoption has been completed through the department's SOP process.		**Responsibility:** Dep. Dir. CP-RE
3	*Jointly develop a process with the Accounting Division for timely reporting of donated real estate assets to improve recordkeeping.*	**Concur**	Expected Completion: **Complete**
	Comments: Process has been implemented and monthly reporting has been established.		**Responsibility:** RE Prog. Mgr.
4	*Define qualification criteria in policies and procedures for hiring and engaging appraisers*	**Concur**	Expected Completion: **Complete**
	Comments: Currently advertising RFQ to define and establish criteria.		**Responsibility:** RE Prog. Mgr.

5	*Codify Real Estate Specialist training requirements to provide greater assurance that staff is constantly abreast of updated laws and procedures relating to acquisitions.*	**Concur**	Expected Completion: **Complete**
Comments: Licensed RE Specialists have required continuing education to maintain licensure. Additionally, industry training is offered, recommended and required as appropriate, when applicable to legal updates impacting eminent domain acquisition processes.			**Responsibility:** Dep. Dir. CP-RE

Audit of Capital Projects Administration:
Property Acquisition

Follow-Up Review

The Real Estate Division has implemented effective procedures for acquisition of real estate assets and their reporting to Accounting; however, document retention processes need improvement.

A request for qualifications process was completed to ensure qualified appraisers are available for valuation of real estate assets prior to their acquisition. In addition, training requirements for all staff have been established.

Audit Team

City Auditor
Madison Rorschach, CIA, CGAP

Audit Staff
Neeraj Sama, MBA, MS

215 E. McKinney St., Denton, TX 76201 ○ (940) 349-7228

Table of Contents

Follow-Up at a Glance

Why we did this Follow-Up:

This report is intended to provide information on what changes have been made in response to the Audit of Capital Projects Administration: Property Acquisition issued in May 2020. The original audit evaluated the Rel Estate Division's property acquisition process for capital projects. This follow-up review was included in the City's fiscal year 2021-22 Annual Internal Audit Plan as approved by the City Council.

What we Found:

The Real Estate Division has implemented effective standard operating procedures that outline the negotiation process for acquiring real estate assets and reporting these to the Accounting Division; however, some critical documentation was not easily found. In addition, Real Estate has adopted a standard operating procedure that requires allstaff to receive training and has established qualifications for hired appraisers. The status of each recommendation is summarized below:

Recommendation	Mgmt. Response	Status
1. Require Real Estate Staff to execute and maintain all required documents properly for acquisition of real estate properties in line with implemented real estate acquisition process	Concurred	In Progress
2. Adopt a formalized negotiation process incorporating the following key requirements: a. Criteria and steps of negotiation with the property owner including a requirement to perform in-depth interviews with property owners to discuss issues such as the impact of the project, property usage by the owner and estimated value of the property; b. Real Estate staff to get approval of the Deputy Director on a formal document recording the agreement on settlement price along with the justification for accepting the price over and above the appraisal value; and c. Limitation on the power of Real Estate Specialists to independently negotiate up to a certain percentage of appraised value and involvement of senior officials beyond that limit.	Concurred	Implemented
3. Jointly develop a process with the Accounting Division for timely reporting of donated real estate assets to improve recordkeeping.	Concurred	Implemented
4. Define qualification criteria in policies and procedures for hiring and engaging appraisers	Concurred	Implemented
5. Codify Real Estate Specialist training requirements to provide greater assurance that staff is constantly abreast of updated laws and procedures relating to acquisitions.	Concurred	Implemented

Audit report translations may be requested by emailing InternalAudit@CityofDenton.com.

Introduction

The Internal Audit Department is responsible for providing: (a) an independent appraisal[1] of City operations to ensure policies and procedures are in place and complied with, inclusive of purchasing and contracting; (b) information that is accurate and reliable; (c) assurance that assets are properly recorded and safeguarded; (d) assurance that risks are identified and minimized; and (e) assurance that resources are used economically and efficiently and that the City's objectives are being achieved.

The Internal Audit Department has completed a follow-up review of the Audit of Capital Projects Administration: Property Acquisition issued in May 2020. We conducted this performance audit 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.

Management Responsibility

City management is responsible for ensuring that resources are managed properly and used in compliance with laws and regulations; programs are achieving their objectives; and services are being provided efficiently, effectively, and economically.

Audit Objectives, Scope, and Methodology

This report is intended to provide a progress update on recommendations from the Audit of Capital Projects Administration: Property Acquisition (May 2020), which evaluated the Real Estate Division's property acquisition process for capital projects.

Audit fieldwork was conducted during February and March 2022. The scope of review varied depending on the procedure being performed. The following list summarizes major procedures performed during this time:

➢ Reviewed documentation from the issued audit to develop criteria including industry standards, best practices, policies, and procedures;

➢ Interviewed Real Estate Division and Finance Department Staff;

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[1] The City of Denton's Internal Audit Department is considered structurally independent as defined by generally accepted government auditing standard 3.56.

➢ Reviewed a judgement sample of 30 right of way acquisitions completed from June 2020 through February 2022;

➢ Reviewed standard operating procedures implemented by the Real Estate Division since the issuance of the original audit covering the real estate asset negotiation, acquired property reporting, and licensed staff training requirements;

➢ Reviewed Real Estate staff's training requirements and documentation; and

➢ Reviewed request for qualifications documentation for evaluation of qualified appraisers.

Recommendation Status Update

This report summarizes the Audit of Capital Projects Administration: Property Acquisition recommendations, management responses, and the Internal Audit Department's follow-up findings, which describe to what extent City management has implemented Internal Audit's recommendations since the publication of the original report in May 2020.

Acquisition Process Documentation Needs to be Improved

1. **Require Real Estate Staff to execute and maintain all required documents properly for acquisition of real estate properties in line with implemented real estate acquisition process.**

   Management Response: Concur
   Direction to execute and maintain documents had previously been given prior to audit. Steps have been implemented to check/confirm compliance monthly.

   Audit Follow-Up Finding: In Progress
   According to the real estate asset acquisition process established in February 2019, which was formally implemented in March 2020, the following steps and associated documents are broadly involved in real estate asset acquisition, as presented in Figure 1 below:
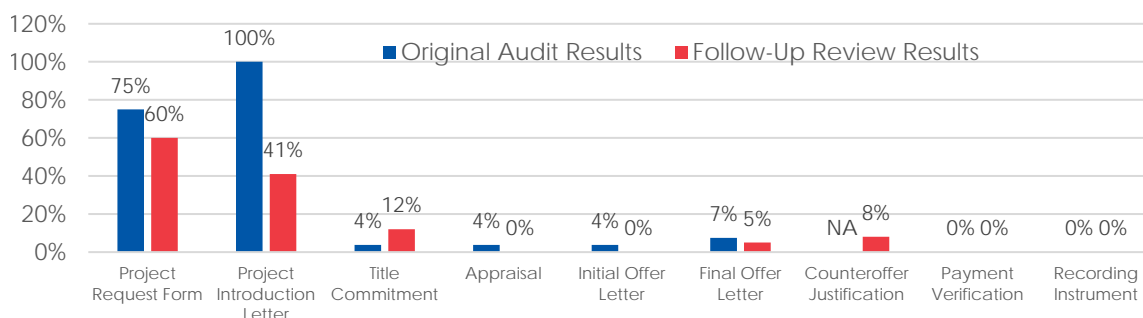
Figure 1: Real Estate Acquisition Process
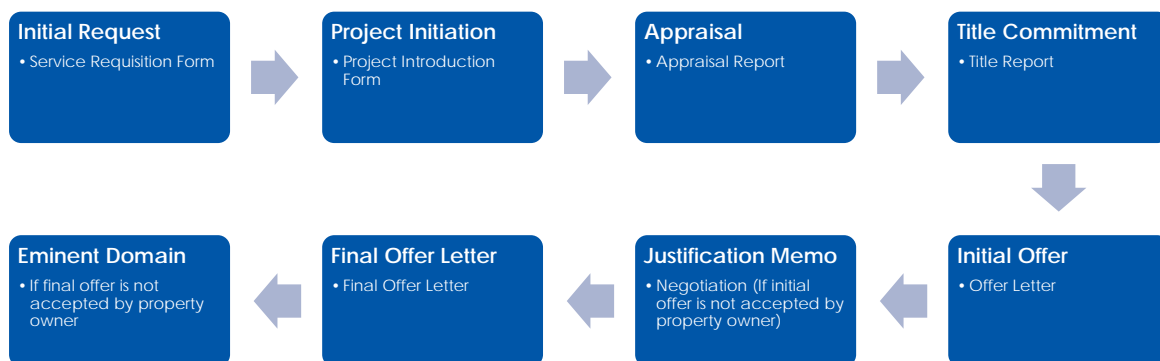
Based on review of a judgement sample of 30 parcels, the Real Estate Division's documentation recording procedures have slightly improved compared to missing document percentages observed for reviewed sample properties[2] in the original audit, as presented in Figure 2.

Figure 2: Missing Documents Comparison

As presented in Figure 2, project request forms and project Introduction letters continue to be missing at high levels for the sample parcels reviewed. That being said, compared to the other documents these present the least risk if they are not executed as it is unlikely this will lead to fraud or financial error. Furthermore, the Real Estate Division has implemented a process to receive real estate acquisition initiation requests from departments through a cloud-based work flow system, enhancing recording keeping and tracking effectiveness.

While other documents, including title commitment, final offer letter, and counteroffer justification memo, are available for most of the reviewed parcels, they must be executed and maintained without fail for each acquisition. If they are missing for any acquisition, the acquisition transaction can not be fully verified, increasing the risk of fraud or error.

Therefore, it can be concluded that there is still room for improvement in executing or maintaining complete transaction documentation following the established real estate acquisition process. Based on discussion with Real Estate Division staff, it is possible that these documents, which are generally maintained physically, are currently in storage due to the Division moving locations. Staff have stated that they are working to locate the missing documents.

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[2] In the original audit, parcels were reviewed in two categories: the prior administration (acquired before February 2017) and the current administration (acquired after). Figure 2 compares the results of parcels reviewed under this follow-up review with the parcels acquired since February 2017.

Negotiation Process is not Formalized

2. **Adopt a formalized negotiation process incorporating the following key requirements:**

    a) **Criteria and steps of negotiation with the property owner including a requirement to perform in-depth interviews with property owners to discuss issues such as the impact of the project, property usage by the owner and estimated value of the property;**

    b) **Real Estate staff to get approval of the Deputy Director on a formal document recording the agreement on settlement price along with the justification for accepting the price over and above the appraisal value; and**

    c) **Limitation on the power of Real Estate Specialists to independently negotiate up to a certain percentage of appraised value and involvement of senior officials beyond that limit.**

Management Response: Concur
Processes for each recommendation were in place at time of audit. Formal adoption has been completed through the department's SOP process.

Audit Follow-Up Finding: Implemented
The Real Estate Division implemented a standard operating procedure in March 2020, which contains the following steps and provisions for negotiation, requirements management approval, and Real Estate Division staff authority limits for acquisition of real estate assets:

a. Negotiation Process: Real Estate Specialists are authorized to negotiate and finalize the price and terms of the proposed real estate asset acquisitions with property owners, including:

    o   Request documentation to support negotiated settlements, including appraisal or newer comparative sales data, or confirmation of an executed contract at a higher per square foot or per acre value;

    o   Act as liaison with the engineers and consultants; and

    o   Prepare a memo for City management providing justification for accepting a negotiated price for a property beyond its appraised value.

b. Management Approval and Limitation on Powers:

> - o Offers under $50,000 must be approved by the Deputy Director of Real Estate and offers above $50,000 are required to be approved by the City Manager after the approval of the City Attorney's Office.
>
> - o Real Estate Specialists are required to get approval from the Deputy Director of Real Estate or City Manager[3] or City Council for any negotiated terms beyond a property's appraised value.

Information about Donated Properties is not Communicated to Accounting

3. **Jointly develop a process with the Accounting Division for timely reporting of donated real estate assets to improve recordkeeping.**

    Management Response: Concur
    Process has been implemented and monthly reporting has been established.

    Audit Follow-Up Finding: Implemented
    The Real Estate Division has developed a reporting system to report acquired real estate assets to Accounting. Based on the last two years' reports, the Real Estate Division reports acquisitions to Accounting staff at least every six months, allowing them to record acquired assets in the City's books appropriately.

    According to the Real Estate Department staff, real estate assets donated to the City are recorded based on the acquired assets' appraised value or Denton Central Appraisal District's appraised value. However, based on review, three assets acquired through donation and reported to Accounting in May 2020 had not been recorded in the City's financial system as of March 2022. In order to verify the effectiveness of the City's fixed assets recording procedures, Internal Audit will consider conducting an audit of fixed assets in the future.

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[3] In accordance with City Ordinance 013-094, the City Manager is authorized to:
  - ➤ Make offers at the appraised value;
  - ➤ Settle at a purchase price up to $100,000 over the appraised value;
  - ➤ Settle at a purchase price up to 20 percent above the appraised amount if it is between $100,000 and $500,000 for capital project; and
  - ➤ Settle at a purchase price up to 20 percent above the appraised amount if it is between $500,000 and $1 million for properties needed for electric projects.

Real Estate Policy Changes Should be Made to Align with Best Practices

4. **Define qualification criteria in policies and procedures for hiring and engaging appraisers**

   Management Response: Concur
   Currently advertising RFQ to define and establish criteria.

   Audit Follow-Up Finding: Implemented
   The Real Estate Division completed a request for qualifications – or RFQ – process in 2020, which defined qualification criteria for hiring licensed appraisers for real estate acquisition projects. The goal of conducting the RFQ process was to identify a list of qualified real estate firms and pre-approve them as eligible to be hired as appraisers by the Real Estate Division for specific projects.

   Based on review, the RFQ process was appropriately conducted, and applicants were evaluated using a scoring system based on their qualifications and other criteria. In July 2020, Denton's City Council approved six appraisers via Ordinance based on this established criteria.

5. **Codify Real Estate Specialist training requirements to provide greater assurance that staff is constantly abreast of updated laws and procedures relating to acquisitions.**

   Management Response: Concur
   Licensed Real Estate Specialists have required continuing education to maintain licensure. Additionally, industry training is offered, recommended, and required as appropriate, when applicable to legal updates impacting eminent domain acquisition processes invoices.

   Audit Follow-Up Finding: Implemented
   The Real Estate Division implemented a standard operating procedure – or SOP – in February 2022, that requires licensed staff to complete and report their training needed to maintain their licenses. Additionally, the SOP has been recently updated to establish training requirements for non-licensed Division staff to ensure that unlicensed staff receive adequate training. The updated SOP is in the process of being implemented.

   In addition, based on our review of training documentation, there was evidence that four of five Division staff members had attended training in the last two years and the remaining staff member had only recently transferred into the Division, indicating that all staff are receiving training.

Glossary of Property Acquisition Steps

➢ **Project Request Form** – is submitted by Project Manager to the Real Estate Division to request real estate asset acquisition for specific projects.

➢ **Project Introduction Letter** - is required to be sent by Real Estate Division to the owners of properties in the project vicinity informing them in advance about the upcoming project and potential acquisitions.

➢ **Title Commitment** – is obtained from title companies to ensure that the title of the properties to be acquired is free from any defect or encumbrances.

➢ **Appraisal Report** – is obtained from qualified appraisers to know the actual worth of the property to be acquired based on the prevailing market price.

➢ **Initial Offer Letter** – is sent to property owners representing the City's terms of acquisition of the property including the purchase price, i.e., appraised value.

➢ **Final Offer Letter** – is issued by the Real Estate staff when property owners do not accept the initial offer and final price is determined after negotiation.

➢ **Counteroffer Justification Memo** – is submitted by the Real Estate Specialist to management stating the justification of price to be offered to property owners beyond the properties' appraisal value.

City of Denton

City Hall
215 E. McKinney St.
Denton, Texas 76201
www.cityofdenton.com

Legislation Text

File #: IAAC24-012, **Version:** 1

AGENDA CAPTION

Receive a report, hold a discussion, and take necessary action regarding the completion and closure of Audit Project 018 - Health Insurance Operations.

City of Denton

AGENDA INFORMATION SHEET

DEPARTMENT: **City Auditor's Office**

CITY AUDITOR: **Madison Rorschach**

DATE: **April 29, 2024**

SUBJECT
Receive a report, hold a discussion, and take necessary action regarding the completion and closure of Audit Project 018 – Health Insurance Operations.

BACKGROUND
In accordance with the City of Denton Ordinance 21-2035, the Internal Audit Advisory Committee is responsible for providing oversight of the internal audit function, including monitoring follow-up on reported findings to assure corrective action is taken by management.

DISCUSSION
An audit project of the City's health insurance operations was originally conducted and reported to the City Council in November 2020. This audit identified a few risks including potential improvements to dependent monitoring and additional monitoring of the City's health insurance third-party administrator.

Since the issuance of this audit, several improvements have been made to the City's procurement process including:

- Completion of a health care claims audit by a third-party vendor;

- Development of a process to regularly receive and review the Third-Party Administrator's service organization controls report and performance guarantee report; and

- Implementation of a process to periodically require employees to attest to their dependent's eligibility.

Internal Audit generally evaluated these process improvements as part of the June 2022 and July 2023 follow-up reviews and believes that these improvements adequately address the recommendations issued as part of the original Audit of Health Insurance Operations.

RECOMMENDATION
Staff recommends approval of the attached Audit Project Completion Form and final closure of Audit Project 018 – Health Insurance Operations. These processes will continue to be considered for review annually as part of the Annual Internal Audit Plan development process.

PRIOR ACTION/REVIEW (Council, Boards, Commissions)
Nov. 10, 2020: Audit of Health Insurance Operations presented, and Project 018 closed till follow-up by Council

Jun. 7, 2022:   Audit of Health Insurance Operations: Follow-Up Review presented; Council directed Project 018 be closed till the performance of an informal follow-up review
Jul. 21, 2023: Fiscal Year 2022-23 Informal Follow-Up Review distributed to City Council via the Friday Report – included information on Project 018

EXHIBITS
1. Agenda Information Sheet
2. Audit Project Completion Form – 018 Health Insurance Operations
3. Audit of Health Insurance Operations
4. Audit of Health Insurance Operations: Follow-Up Review

Respectfully submitted:
Madison Rorschach, 940-349-7228
City Auditor

Audit Project Completion Form

Project Title: Health Insurance Operations   Project Number: 018

Table 1: Project Timeline

Deliverable	Responsible Staff	Audit Plan FY	Date Issued	Months to Complete	Hours to Complete
Audit Report	Neeraj Sama Madison Rorschach	FY2019-20	11/10/2020	2.50	NA
Follow-Up Report	Madison Rorschach Amber Jackson	FY2021-22	06/07/2022	NA	15.75
Informal Follow-Up Report	Madison Rorschach Amber Jackson	FY2022-23	07/21/2023	NA	3.25
			Total:	**2.50**	**19.00**

Concurrent Rate: 100%   Implementation Rate: 100%

Table 2: Project Recommendation Summary

Recommendation	Mgmt. Response	Status
1. Develop and formalize a process for periodically identifying and removing ineligible dependents who are not removed by employees in a timely manner.	Concur	Implemented
2. Periodically conduct a review of adjudicated health insurance claims to verify plan implementation and identify claim processing errors.	Concur	Implemented
3. Develop a process to report to City Management any control weaknesses identified in the Third-Party Administrator's Service Organization Control Report.	Concur	Implemented
4. Annually verify that the city has adequate complementary user organization controls based on the Third-Party Administrator's Service Organization Control Report.	Concur	Implemented
5. Periodically request the Third-Party Administrator provide a list of individuals who have access to the City's eServices Internet Portal and verify that only authorized individuals are included.	Concur	Implemented
6. Clarify the weekly health insurance claim funding reconciliation process in consultation with the Finance Department.	Concur	Implemented
7. Implement monitoring procedures for performance guarantees.	Concur	Implemented

Based on the project timeline and recommendation summary listed previously, the City Auditor recommends this project be closed and considered formally complete:

140

City Auditor: _Madison Rorschach_   Date: _07/31/2023_

AUDIT OF HEALTH INSURANCE OPERATIONS

ABSTRACT

The City has outsourced the administration of health insurance claims. Further monitoring of the Third-Party Administrator would provide further assurance that claims are adjudicated efficiently. In addition, the City has generally established adequate controls over benefits plan management and participant enrollment.

Internal Audit Department

City Auditor
Madison Rorschach, CIA, CGAP

Audit Staff
Neeraj Sama, MBA

Table of Contents

Audit at a Glance

Why we did this Audit:

As a self-funded health insurance provider, the City has a fiduciary duty to its residents and employees to ensure health care services are being provided economically. Annually, the City pays over $25 million in health insurance claims for City employees and their dependents. This audit was included on the City's fiscal year 2019-20 Audit Plan as approved by the City Council.

What we Recommend:

Recommendation 1
Periodically identify and remove ineligible dependents who are not removed by employees in a timely manner.

Recommendations 2, 3, & 4
Regularly review the Third-Party Administrator's claims processing controls and report results to City Management.

Recommendation 5
Annually verify that all individuals with access to the City's health insurance portal are authorized.

Recommendations 6
Clarify the claims reimbursement reconciliation process.

Recommendation 7
Implement procedures to verify that the Third-Party Administrator is meeting performance guarantees.

What we Found:

The City has outsourced the administration of health insurance claims to a Third-Party Administrator; however, it is responsible for managing the benefits plans offered to employees as well as participant enrollment. Findings for each of these processes are summarized below:

Benefits Plan Management. The City has developed two health insurance plans with the assistance of an Employee Benefits Consultant who negotiates with health care providers and facilitates plan compliance with applicable regulations. The Consultant also provides regular reports on plan and network utilization, which adequately allows the City to monitor health insurance operations funding levels.

Participant Enrollment. The City has developed adequate controls to ensure changes in health insurance plan enrollment are communicated to the Third-Party Administrator. In addition, the City is adequately verifying that employees' dependents are eligible for coverage when enrolled; however, there is no process to periodically verify that dependents are still eligible for coverage.

Claims Administration. The City's Third-Party Administrator appears to have developed adequate controls over claims administration; however, the City should regularly review available independent audit and performance reports to ensure this continues. In addition, conducting an independent review of adjudicated claims could help identify claim processing & plan implementation errors and verify that performance guarantees are met.

Finally, the City has an effective process for funding health insurance claims. Still, updating this process documentation to include Finance's responsibility would facilitate consistency and provide clarity on funding authorization levels.

Audit report translations may be requested by emailing InternalAudit@CityofDenton.com.

Introduction

The Internal Audit Department is responsible for providing: (a) an independent appraisal[1] of City operations to ensure policies and procedures are in place and complied with, inclusive of purchasing and contracting; (b) information that is accurate and reliable; (c) assurance that assets are properly recorded and safeguarded; (d) assurance that risks are identified and minimized; and (e) assurance that resources are used economically and efficiently and that the City's objectives are being achieved.

The Internal Audit Department has completed a performance audit of health insurance operations. We conducted this performance audit 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.

Management Responsibility

City management is responsible for ensuring that resources are managed properly and used in compliance with applicable regulations; programs are achieving their objectives; and services are being provided efficiently, effectively, and economically.

Audit Objectives, Scope, and Methodology

The Internal Audit Department has completed an audit of health insurance operations including benefits plan management, participant enrollment, and claims administration. This report is intended to provide assurance that City management has established adequate processes and procedures to ensure health insurance operations are effective, efficient, and economical.

Audit fieldwork was conducted during September and October of 2020. The scope of review varied depending on the procedure being performed. The following list summarizes major procedures performed during this time:

- Reviewed documentation to develop criteria including industry standards, best practices, policies, and procedures;

- Developed process narratives to identify current control activities in the participant enrollment and claim funding processes that was certified by Risk Management and Finance staff;

- Interviewed Risk Management and Finance staff as well as representatives from the City's Employee Benefits Consultant firm;

- Inspected a statistical sample of 78 dependents[2] eligibility documentation to ensure they were verified according to the City's requirements and reviewed the 2019 Dependent Eligibility Audit results;

Page 4

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[1] The City of Denton Internal Auditor's Office is considered structurally independent as defined by generally accepted government auditing standard 3.56.

[2] This sample size provides with 95% confidence that the true sample mean is within ±15% of the sample estimate.

- Reviewed contracts entered with the Third-Party Administrator and Employee Benefits Consultant;

- Assessed the Third-Party Administrator's 2019 Service Organization Control Report and the 2017, 2018, and 2019 Performance Guarantee Reports; and

- Examined supporting documentation for payments made to the Third-Party Administrator for administrative fees and claims reimbursement.

Findings & Analysis

Health insurance operations have three functional parts that must work together to ensure health care services are provided effectively. The City of Denton is a self-funded health insurance provider, meaning that it is ultimately responsible for all three parts including the sole responsibility for paying all health insurance claims.[3] These parts and associated processes are shown in Figure 1.

Figure 1: Health Insurance Operations

| Benefits Plan	•Plan & Network Development •Utilization Monitoring
Enrollment	•Coverage Change Management •Participant Eligibility
Claims	•Processing •Payment funding
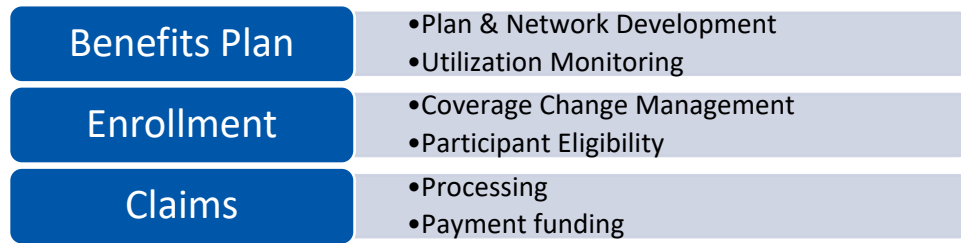
In general, the Risk Management Division of the Human Resources Department is responsible for directing the City's health insurance operations. The City has contracted with two outside vendors to provide the following services:

➤ The Employee Benefits Consultant assists in developing the benefits plan and provider network as well as monitoring plan utilization; and

➤ The Third-Party Administrator[4] processes health insurance claims including receipt and adjudication.[5]

The City of Denton accounts for its health insurance plan contributions and claim payments in a separate Health Insurance Fund.[6] Figure 2 illustrates the associated revenues and expenses.

Figure 2: Health Insurance Contributions & Payments Summary

Legend: Employee Contributions | City Contributions | Health Insurance Payments

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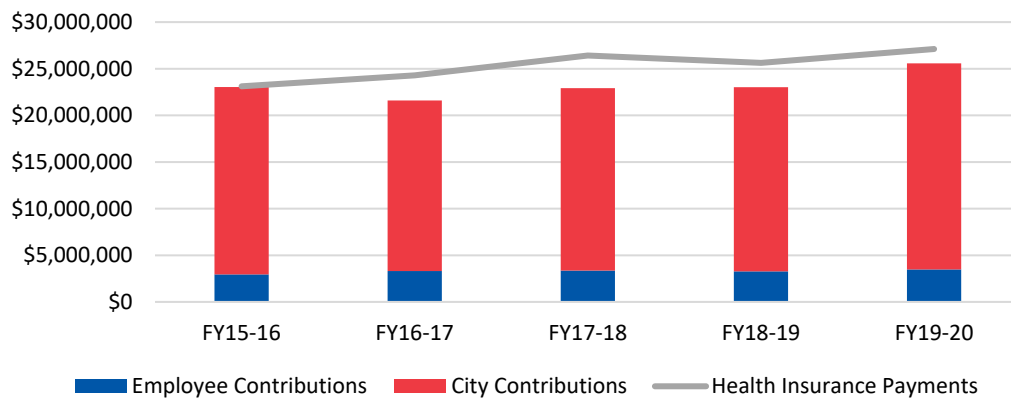
[3] A Self-Funded Health Insurance Plan is different than a Traditional Health Insurance Plan, in which the City would pay a Health Insurance provider administration fees and premiums to manage all aspects of the health insurance operations.

[4] The Health Insurance Third-Party Administrator is not responsible for processing workers' compensation claims.

[5] Health insurance claim adjudication encompasses determining how a benefits plan applies to a claim.

[6] The Health Insurance Fund also accounts for dental, vision, and disability coverage contributions and payments as well as the costs to operate a City health clinic.

This audit generally evaluated all parts of the City's health insurance operations including benefits plan management, participant enrollment, [7] and claims administration. The City also operates a health clinic for its employees; however, clinic operations were not evaluated as part of this audit.

Medical Benefits Plans are Appropriately Monitoried for Compliance & Utilization

As a self-funded health insurance provider, the City is responsible for developing and managing its own health insurance plan including:

- ➢ Deciding what benefits employees will receive;
- ➢ Establishing a health care provider network;
- ➢ Monitoring plan utilization and projecting funding needs; and
- ➢ Ensuring compliance with applicable regulations.

What We Found

- The City has contracted with McGriff, Seibels & Williams, Inc. (McGriff) to assist its Risk Management staff in these efforts as an Employee Benefits Consultant.
    - o McGriff generally appears to be complying with its contract conditions and is adequately assisting with the administration of the City's benefits plans.

- McGriff assists the City in creating and administering its health insurance plans and contracting with health care providers and Third-Party Administrators as needed.

- McGriff periodically provides claims analysis reports to the City which cover the City's benefits plans' expenses, plan and network utilization, claim trends, and other information enabling City staff to effectively manage and report on health insurance claims.

- Monthly, the City holds Employee Insurance Committee meetings to review claim payments and plan and network utilization. McGriff representatives attend the meetings to provide advice on current issues, if needed.

- The City manages compliance with health insurance benefits related rules and regulations with McGriff's assistance.
    - o McGriff tracks the City's compliance with ERISA, COBRA, HIPAA, the Affordable Care Act, and other applicable rules and regulations and provides regular compliance deadline updates, City-specific compliance checklists, and legal disclosure guides to the City staff for proper compliance.

Why It Matters

As a self-funded health insurance provider, the City has a fiduciary duty to its employees and residents to ensure it is appropriately monitoring plan utilization and compliance. The City has established effective monitoring procedures to ensure its health insurance plan is adequately utilized. In addition, information and guides provided by McGriff provide further assurance that

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[7] Enrolled City employees and their dependents are considered participants.

the City is complying with all applicable regulations – including its fiduciary duty. These processes help the City lower costs and avoid potential non-compliance penalties.

Recommendation: None

Plan Enrollment is Adequately Managed; Dependent Monitoring Could Lower Costs

The City is required to pay its Third-Party Administrator an administration fee for each participant enrolled in its health insurance plans. Similar to other organizations, the City offers health insurance coverage to its employees and their dependents; the City considers the following individuals dependents:

- An employee's legal spouse
- An employee's common law spouse
- An employee's natural child, stepchild, or adopted child
- A child under the employee's legal guardianship

The City offers its employees and their dependents Gold and Silver health insurance plans, which have differing levels of coverage. Employees may choose either plan or may elect to not enroll in a City health insurance plan. At the end of fiscal year 2019-20 the City had a total of 1,326 employees enrolled with an additional 2,207 dependents as illustrated in Figure 3.

Figure 3: City Health Insurance Plans Enrollment (FY19-20 Year End)
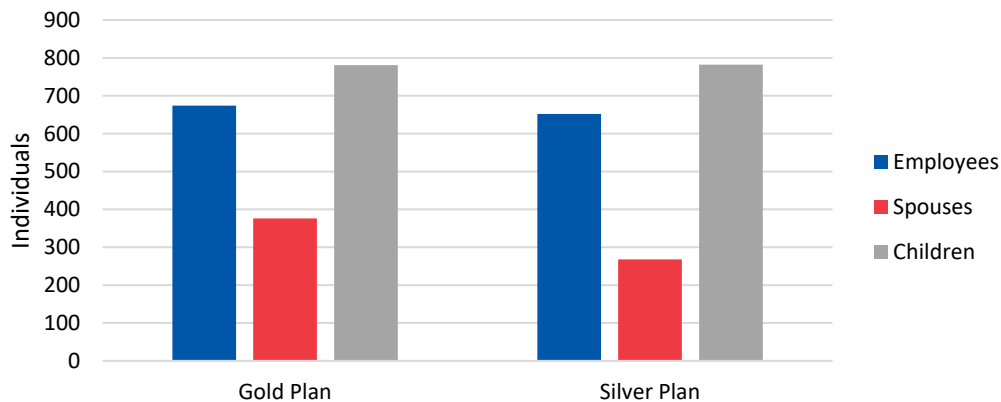
What We Found

- Weekly, the City's benefits system automatically communicates plan enrollment changes to the Third-Party Administrator.
  - Enrollment is verified monthly as part of the Third-Party Administrator's administration fee invoicing. Based on a review of three sample invoices paid during the past three fiscal years, all bills were accurately paid based on the contracted price per enrollee and the number of enrollees per health insurance plan as of the billing date.

- The City requires new and existing employees to submit dependent eligibility documentation when new dependents are added to their health insurance plan. In order to verify eligibility, an employee must complete a Dependent Verification Form and submit certain legal documents

that support the relationship between the employee and dependent. These documents typically include the following:

- o   Marriage certificate;

- o   Birth certificate; and

- o   Court document that establishes the relationship between the employee, or their spouse, and the child.

- Prior to fiscal year 2019-20, there was no process to verify new dependents' eligibility. During 2019, the City hired an outside consultant to conduct a dependent eligibility audit. This audit found that about 98 percent of the City's dependents were eligible for coverage as shown in Table 1.

Table 1: Dependent Audit Results (Oct. 2019)

Audit Status	Dependents	Percentage
Passed	2,299	97.9%
No Response	26	1.1%
Incomplete	18	0.8%
Ineligible	5	0.2%
Total:	2,348	100.0%

- o   Of the 49 employees who did not pass the 2019 Dependent Eligibility Audit, 17 were still covered by the City's health insurance at the end of fiscal year 2019-20. Based on discussions with Risk Management staff, two of these dependents had not been adequately verified since completion of the audit. These two dependents have since been adequately verified and remain covered by the City's health insurance plans.

- Based on a statistical sample of employees whose coverage began after Oct. 2019 and before Oct. 2020, about 96 percent of dependents' eligibility was verified as per the City's requirements. These sample results are shown in Table 2.

Table 2: Dependent Verification Sample Results (FY19-20 Year End)

Verification Method	No. of Dependents	Percentage
Dependent Audit	42	53.85%
Submitted Documentation	33	42.31%
Process Exception[8]	2	2.56%
Not Verified	1	1.28%
Total:	78	100.00%

- o   Only one dependent reviewed as part of the sample was not verified prior to enrollment. This dependent was enrolled in coverage after the 2019 Dependent Eligibility Audit began, but before the new dependent eligibility verification process was implemented. Based on a review of current dependent coverage dates, there may be about 20 additional dependents who were not verified when their coverage was initiated.

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[8] These dependents were not enrolled per the City's stated eligibility verification process; however, both appeared to be eligible upon review.

- The City's benefits system automatically removes dependent children who age out of coverage from the City's health insurance.

    o Of a judgement sample of 47 dependents who aged out of the City's health insurance plan between Oct. 2019 and Oct. 2020, all were appropriately removed.

    o Other than this automatic removal process, there is no process to periodically verify that dependents are still eligible for coverage, which increases the risk that dependents such as spouses and stepchildren may remain covered inappropriately.

- For the plan year 2021 open enrollment process, employees are required to attest that their enrolled dependents are eligible per the City's requirements. This practice should help remind employees of their responsibility to remove ineligible dependents.

Why It Matters

The number of participants enrolled in a health insurance plan is the most critical cost driver. For that reason, it is critical to ensure that the Third-Party Administrator receives accurate enrollment information and that any changes are promptly communicated. The City has established adequate processes to communicate and confirm enrollment changes with the Third-Party Administrator.

Similarly, ensuring that only eligible dependents are enrolled demonstrates that the City meets its fiduciary duty and ultimately reduces costs to City employees and Denton residents. While performing this verification before enrollment decreases this risk, periodically verifying that dependents remain eligible would provide further assurance that these savings are realized.

Recommendation:

1. Develop and formalize a process for periodically identifying and removing ineligible dependents who are not removed by employees in a timely manner. It may be appropriate to focus these monitoring efforts on spouses and stepchildren who are at a higher risk of becoming ineligible than other dependents.

    Risk Management Comments: The Risk Management department concurs. Because the City relies on the employee to notify when a change in familial status occurs annually within six months of the close of open enrollment, a report will be run to identify dependents who are on the Plan. A sample of the dependents will be identified, and dependents' eligibility will be verified through a review of eligibility documents previously provided and by contacting the employee to verify that the dependent is still eligible to be on the Plan.

Claim Administration Controls Appear Adequate but Should be Regularly Reviewed

The City has entered into a contract with United Healthcare to act as a Third-Party Administrator for its health insurance plans. As Third-Party Administrator, United Healthcare is responsible for the claims administration process, which is outlined in Figure 4:

Figure 4: Claim Administration Process
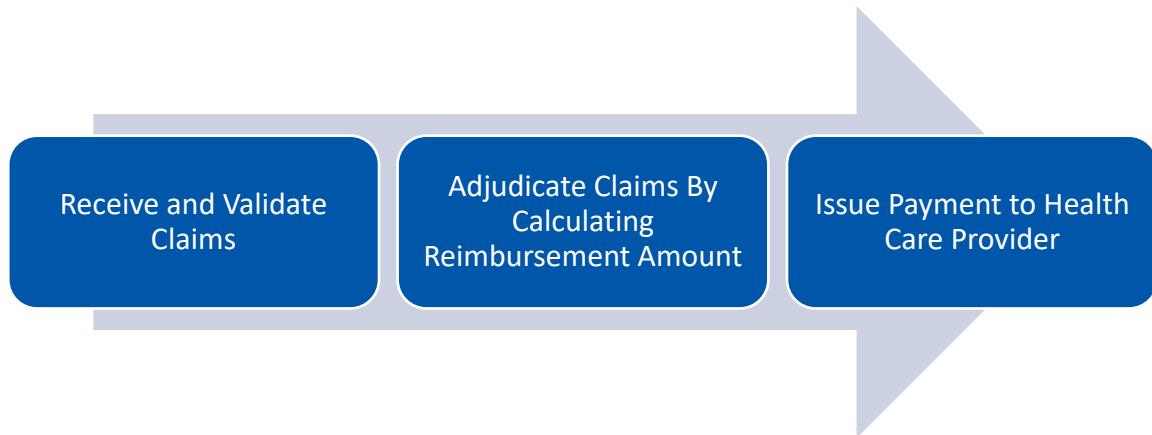
Annually, this process is evaluated by an independent public accounting firm in accordance with the American Institute of Certified Public Accountants Statement on Standards for Attestation Engagements No. 18. The results of this evaluation are communicated in a Service Organization Control (SOC) Report, which describes the reviewed process, reports on any material control weaknesses, and recommends controls that user entities should employ in their own organizations.

What We Found

- The City does not conduct any independent review of adjudicated claims to verify that the Third-Party Provider is implementing the City's health insurance plans as intended. Based on discussions with Risk Management staff, this is due to concerns that such review would violate the Health Insurance Portability and Accountability Act (HIPAA).

- United Healthcare is required to provide the most recent SOC report to the City upon request by contract; however, the City does not have a process to regularly obtain and review this report.

- The 2019 SOC Report found that United Healthcare's claims administration process controls were suitably designed to provide reasonable assurance if complementary user controls were operating effectively.

  - Based on a review of the controls described within the 2019 SOC Report, there do not appear to be any control weaknesses that should concern the City.

- The 2019 SOC Report recommends several complementary controls that a user entity – such as the City – should implement. These controls are outlined in Table 3. The City should ensure these controls are implemented to most effectively use United Healthcare's services.

  - In general, the City appears to have adequately implemented City processes that align with the recommended controls; however, improvement is needed in two processes[9] to adequately address associated risks.

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[9] The claim payment funding authorization process is addressed in the next section.

Table 3: Complementary City Process Assessment

Recommended Control	Assessment Result[10]
The user's customer benefit plan is complete, authorized, and furnished to United Healthcare promptly.	Adequate
Enrollment files are complete, accurate, and timely when submitted.	Adequate
Only authorized users have access to the United Healthcare information available on the eServices Portal.	Improvement Needed
Available claim payment funds are authorized.	Improvement Needed
Claim charges are funded completely and timely.	Adequate
User reconciles monthly invoices using the number of enrollees and contracted rates.	Adequate
Relevant financial performance reports are obtained and used appropriately.	Adequate
User completes any needed actuarial analysis.	Not Reviewed[11]

- Specifically, the City does not have a process to periodically review user access to the eServices Portal. While access is generally managed by Risk Management staff, periodically requesting a user report from United Healthcare would provide further assurance that only authorized users have access to sensitive health insurance information.

  - In response to the audit, Risk Management reviewed user access to the eServices Portal and removed three individuals' access.

Why It Matters

Due to HIPAA regulations, the City is unable to perform its own review of adjudicated claims. Still, conducting an outside review could help identify any health insurance plan implementation errors and provide further assurance that claim administration controls are effective – potentially saving money in future years.

Similarly, regular review of controls implemented by the Third-Party Administrator for its claim administration activities is essential for quickly identifying any material control weaknesses or exceptions that could increase the risk of errors or irregularities when adjudicating claims. Additionally, the Third-Party Administrator's controls, as assessed in the SOC Report, are developed based on the assumption that the recommended complementary controls are functioning in the user entity. Establishing a procedure to regularly review and report on the claims administration controls – including the City's complementary controls – would increase assurance that claims are processed efficiently and further demonstrate the City's commitment to fulfilling its fiduciary duty.

Finally, periodically reviewing user access to the City's eServices Internet Portal provides increased assurance that unauthorized users do not have access to sensitive health insurance claim information.

Page 12

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[10] Assessment results are generally detailed in other sections of this report.

[11] According to Risk Management staff, the City's Employee Benefits Consultant conducts actuarial analysis as needed; however, this analysis was not examined as part of this audit.

Recommendations:

2. Periodically conduct a review of adjudicated health insurance claims to verify plan implementation and identify claim processing errors. Best practices suggest that the period between Third-Party Administrator audits be based on previous audit results and changes to the benefits plan design. In addition, performance guarantees could be verified as part of this process.

   Risk Management Comments: The Risk Management department concurs with this recommendation. In response to this recommendation, the Risk and Compliance Manager has requested price quotes for an external claims audit. When quotes are received, a determination will be made regarding funds availability in this year's budget.

3. Develop a process to report to City Management any control weaknesses identified in the Third-Party Administrator's Service Organization Control Report. If weaknesses are identified, City Management should develop a plan to appropriately address these weaknesses.

   Risk Management Comments: The Risk Management department concurs with this recommendation. The department obtained the current report during the audit process and requested that moving forward, McGriff provide the report on an annual basis as part of our Plan mid-year review. At the mid-year review, the report will be reviewed, and we will work with McGriff and the TPA to address any areas of concern. Should any areas of concern be identified, the Risk and Compliance Manager will notify City leadership about the concerns and the processes put in place to address the concerns on an ongoing basis.

4. Annually verify that the City has adequate complementary user organization controls based on the Third-Party Administrator's Service Organization Control Report.

   Risk Management Comments: The Risk Management department concurs with this recommendation. Based on the SOC report received and reviewed at our Plan mid-year review as described above, the department will review and work with McGriff and the TPA to put in place any additional complementary controls needed to address any concerns.

5. Periodically request the Third-Party Administrator provide a list of individuals who have access to the City's eServices Internet Portal and verify that only authorized individuals are included.

   Risk Management Comments: The Risk Management department concurs with this recommendation. The Benefits Supervisor will request a user report from the TPA at the end of each Plan Year and when an employee begins work with the Benefits Team (on a temporary or permanent basis) to ensure only authorized individuals are permitted access to the employer services portal. Additionally, when any team member departs the Benefits Team, the Benefits Supervisor will ensure the team member's access is removed on or before their last day with the team.

Claims Funding Process Should be Clarified

As a self-funded insurer, the City is solely responsible for paying all health insurance costs for its participants. Over the past three fiscal years, the City has paid approximately $65.3 million in health insurance claims, or about $85,000 in claims a day. Figure 5 generally outlines the claim submission and payment process.

Figure 5: Health Insurance Claim Payment Process
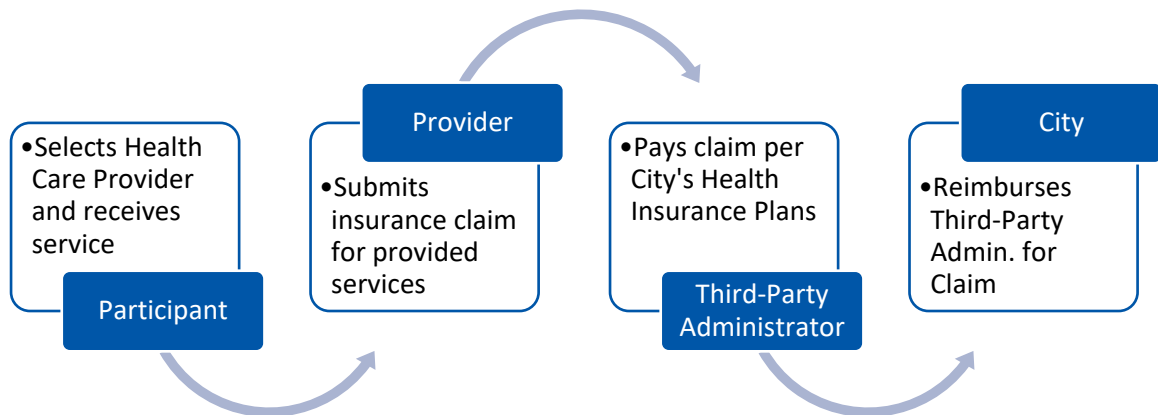
What We Found

- The City has setup an escrow account from which the Third-Party Administrator is able to reimburse themselves for each day's health insurance claims. Notification of these withdrawals are sent to Risk Management staff each business day.

  o The City's bank automatically refunds this account each day to ensure that a balance of $206,000 is maintained.

  o Any withdrawals greater than $700,000 must be approved by the Treasury Manager prior to transfer.

- Each week, Risk Management staff prepare an Outgoing ACH Confirmation Form, which includes a copy of each withdrawal notification and that week's Paid Claims Report. Based on a judgement sample, an average of about $421,000 was authorized each week over the past twelve months via this process.

  o Based on a review of documentation, health insurance claim funding has been authorized inconsistently over the past twelve months. In particular, a sample of twelve reconciliations were always approved by the Risk & Compliance Manager; however, only five reconciliations were approved by the Finance Director and one additional reconciliation was approved by an Asst. Finance Director.

  o Risk Management has created a Standard Operating Procedure to guide staff in preparing the ACH Confirmation Form; however, this document does not include information about Finance's role in the process. Similarly, there does not appear to be written guidance on who should authorize health insurance claim funding; however, the City generally requires the following authorizations for outside funding transfers:

Table 4: Transfer Authorization Thresholds

Employee Role	Min. Amount
Supervisor	$0
Dept. Director	$5,000
Asst. Finance Director	$50,000
Finance Director	$100,000

- Accounting staff records the daily withdrawals weekly in the City's Health Insurance Fund based on this reconciliation process.

Why It Matters

Documented policies and procedures help an organization retain institutional knowledge, navigate emergency situations, and facilitate consistency. This is particularly important when a process involves multiple departments and has a relatively high volume of transactions. The City has developed a claim funding reconciliation process that ensures the following:

➢ Adequate funds for claim payments are available when needed; and

➢ Claim payments are recorded in the City's ledger promptly.

Steps involved in this process have been documented to some extent; however, it does not include information about Finance's role in the process, which has made it difficult for Risk Management and Finance staff to understand each others' responsibilities. Likewise, it is unclear at what level of the organization health insurance claims funding should be authorized. Updating this documentation would facilitate clear understanding and potentially increase efficiency.

Recommendation:

6. Clarify the weekly health insurance claim funding reconciliation process in consultation with the Finance Department. This documentation should clearly identify roles and responsibilities in the process as well as clarify funding authority levels.

   Risk Management Comments: The Risk Management department concurs with this recommendation. The Benefits Team has the claims funding reconciliation process documented up to the point where the process transitions to the Finance department. The Benefits Supervisor and Benefits and HRIS Specialist will work with Finance to document the full process in one complete document.

Periodic Verification of the TPA's Performance Would Increase Assurance

United Healthcare is obligated to maintain certain performance standards as agreed upon in its contract. Best practices on monitoring a Third-Party Administrator's performance recommend requiring and monitoring performance guarantees.

What We Found

- The City's contract with United Healthcare – the Third-Party Administrator – generally contains provisions that align with best practices including: stated performance guarantees, a right to

audit clause, record retention requirements, access to data, and access to Service Organization Control Reports and other information to administer the plan.

- The City does not have a procedure to obtain and review United Healthcare's annual Performance Guarantee reports.

  o While the City's Employee Benefits Consultant does annually review the Performance Guarantee reports, there was no documentation indicating that the Consultant provides these Reports or a summary of the results to the City.

- United Healthcare appears to be 100 percent compliant with claims administration performance guarantees, as shown in Table 5. In addition, performance guarantees for customer service and satisfaction were fully achieved for the 2018 and 2019 plan years.

  o It should be noted that Performance Guarantee Results are self reported by United Healthcare and are not verified by the City or the Employee Benefits Consultant. Without an independent verification process, there is risk that performance guarantees are reported inaccurately.

Table 5: United Healthcare's Performance Guarantee Results (2018 & 2019)

Performance Standard	Guaranteed Percentage	Actual Percentage 2018	Actual Percentage 2019
Claims Processed within 10 Business Days	94%	98.80%	98.80%
Dollar Accuracy	99%	99.89%	99.92%
Procedural Accuracy	97%	99.84%	99.77%

- The Performance Guarantee Report also reconciles the administration fees and stop loss premiums[12] earned by the Third-Party Administrator to those paid by the City. During this reconciliation process, United Healthcare also calculates performance guarantee noncompliance penalties, prescription discount and rebate credits, and stop loss insurance adjustments.

  o During the past three plan years United Healthcare reported that they owed the City $35,276 and $72,705 for prescription discount rate guarantees for 2017 and 2019 respectively. These amounts were appropriately credited to the City as part of the administrative fee payment process.

Why It Matters

The City has appropriately established performance standards that its Third-Party Administrator must meet along with corresponding penalties for noncompliance. Despite United Healthcare producing annual performance reports, Risk Management staff does not appear to be reviewing these reports to verify compliance.

Regular monitoring of the Third-Party Administrator's performance guarantees would assure the City that it duly achieves performance standards for claims administration as agreed and would allow for timely follow up of performance guarantee penalty payments. In addition, an

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[12] The City separately has contracted with United Healthcare to provide Stop Loss insurance for the City's self-funded health insurance plan. Stop Loss insurance protects against catastrophic or unpredictable losses.

independent review, as described in Recommendation 2, would also provide an opportunity to verify that Performance Guarantees are being met as reported.

Recommendation:

7. Implement monitoring procedures for performance guarantees. The City staff should also ensure that United Healthcare duly pays the penalties for non-performance, if any, relating to claims processing and other agreed performance guarantees.

   Risk Management Comments: *The Risk Management department concurs with this recommendation. The Risk Management department will request that McGriff provide the Performance Guarantee report annually as part of our Plan year-end review. Upon review of the report, we will work with McGriff and the TPA to address any concerns.*

Appendix A: Management Response Summary

The following summarizes the recommendations issued throughout this report. The auditors found that staff and the Department were receptive and willing to make improvements to controls where needed. Management has provided their response to each recommendation.

1	*Develop and formalize a process for periodically identifying and removing ineligible dependents who are not removed by employees in a timely manner.*	**Concur**	Expected Completion: Q4 2021
	Comments: The Risk Management department concurs. Because the City relies on the employee to notify when a change in familial status occurs annually within six months of the close of open enrollment, a report will be run to identify dependents who are on the Plan. A sample of the dependents will be identified, and dependents' eligibility will be verified through a review of eligibility documents previously provided and by contacting the employee to verify that the dependent is still eligible to be on the Plan.		Responsibility: Benefits & HRIS Spec/Benefits Supervisor
2	*Periodically conduct a review of adjudicated health insurance claims to verify plan implementation and identify claim processing errors.*	**Concur**	Expected Completion: Q3 2021
	Comments: The Risk Management department concurs with this recommendation. In response to this recommendation, the Risk and Compliance Manager has requested price quotes for an external claims audit. When quotes are received, a determination will be made regarding funds availability in this year's budget.		Responsibility: Risk & Compliance Mgr
3	*Develop a process to report to City Management any control weaknesses identified in the Third-Party Administrator's Service Organization Control Report.*	**Concur**	Expected Completion: Q4 2021
	Comments: The Risk Management department concurs with this recommendation. The department obtained the current report during the audit process and requested that moving forward, McGriff provide the report on an annual basis as part of our Plan mid-year review. At the mid-year review, the report will be reviewed, and we will work with McGriff and the TPA to address any areas of concern. Should any areas of concern be identified, the Risk and Compliance Manager will notify City leadership about the concerns and the processes put in place to address the concerns on an ongoing basis.		Responsibility: Benefits Supervisor/Risk & Compliance Mgr
4	*Annually verify that the City has adequate complementary user organization controls based on the Third-Party Administrator's Service Organization Control Report.*	**Concur**	Expected Completion: Q4 2021
	Comments: The Risk Management department concurs with this recommendation. Based on the SOC report received and reviewed at our Plan mid-year review as described above, the department will review and work with McGriff and the TPA to put in place any additional complementary controls needed to address any concerns.		Responsibility: Benefits Supervisor/Risk & Compliance Mgr
5	*Periodically request the Third-Party Administrator provide a list of individuals who have access to the City's eServices Internet Portal and verify that only authorized individuals are included.*	**Concur**	Expected Completion: January 2021
	Comments: The Risk Management department concurs with this recommendation. The Benefits Supervisor will request a user report from the TPA at the end of each Plan Year and when an employee begins work with the Benefits Team (on a temporary or		Responsibility: Benefits Supervisor

permanent basis) to ensure only authorized individuals are permitted access to the employer services portal. Additionally, when any team member departs the Benefits Team, the Benefits Supervisor will ensure the team member's access is removed on or before their last day with the team.

6	*Clarify the weekly health insurance claim funding reconciliation process in consultation with the Finance Department.*	**Concur**	Expected Completion: Q2 2021
	Comments: The Risk Management department concurs with this recommendation. The Benefits Team has the claims funding reconciliation process documented up to the point where the process transitions to the Finance department. The Benefits Supervisor and Benefits and HRIS Specialist will work with Finance to document the full process in one complete document.		Responsibility: Benefits & HRIS Specialist, Benefits Sup, and Finance
7	*Implement monitoring procedures for performance guarantees.*	**Concur**	Expected Completion: Q2 2021
	Comments: The Risk Management department concurs with this recommendation. The Risk Management department will request that McGriff provide the Performance Guarantee report annually as part of our Plan year-end review. Upon review of the report, we will work with McGriff and the TPA to address any concerns.		Responsibility: Benefits Sup/Risk & Compliance Mgr

Audit of Health Insurance Operations

Follow-Up Review

The City's Risk Management Division has improved monitoring of employee dependents and clarified the claims funding reconciliation process.

In addition, the Division has generally established processes to improve Third-Party Administrator monitoring, including having a healthcare claims audit performed by an external vendor; however, regular review of the Service Organization Control Report would further improve monitoring efforts.

Audit Team

City Auditor
Madison Rorschach, CIA, CGAP

Audit Staff
Amber Jackson, MBA, CFE

Table of Contents

Follow-Up at a Glance

Why we did this Follow-Up:

This report is intended to provide information on what changes have been made in response to the Audit of Health Insurance Operations issued in November 2020. The original audit evaluated the City's health insurance operations including benefits plan management, participant enrollment, and claims administration. This follow-up review was included on the City's fiscal year 2021-22 Annual Internal Audit Plan as approved by the City Council.

What we Found:

The City's Risk Management Division has begun requiring employees to annually attest that their dependents meet the City's eligibility standard and has clarified the health insurance claims funding reconciliation process. In addition, the Division has generally established processes to improve Third-Party Administrator monitoring including annual verification of those who have access to the Third-Party Administrator's internet portal, annual review of performance guarantees, and having a healthcare claims audit conducted. However, a process has not been established to regularly review the Third-Party Administrator's Service Organization Control Report. The status of each recommendation is summarized below:

Recommendation	Mgmt. Response	Status
1. Develop and formalize a process for periodically identifying and removing ineligible dependents who are not removed by employees in a timely manner.	Concurred	Implemented
2. Periodically conduct a review of adjudicated health insurance claims to verify plan implementation and identify claim processing errors.	Concurred	Implemented
3. Develop a process to report to City Management any control weaknesses identified in the Third-Party Administrator's Service Organization Control Report.	Concurred	In Progress
4. Annually verify that the City has adequate complementary user organization controls based on the Third-Party Administrator's Service Organization Control Report.	Concurred	In Progress
5. Periodically request the Third-Party Administrator provide a list of individuals who have access to the City's eServices Internet Portal and verify that only authorized individuals are included.	Concurred	Implemented
6. Clarify the weekly health insurance claim funding reconciliation process in consultation with the Finance Department.	Concurred	Implemented
7. Implement monitoring procedures for performance guarantees.	Concurred	Implemented

Audit report translations may be requested by emailing InternalAudit@CityofDenton.com.

Introduction

The Internal Audit Department is responsible for providing: (a) an independent appraisal[1] of City operations to ensure policies and procedures are in place and complied with, inclusive of purchasing and contracting; (b) information that is accurate and reliable; (c) assurance that assets are properly recorded and safeguarded; (d) assurance that risks are identified and minimized; and (e) assurance that resources are used economically and efficiently and that the City's objectives are being achieved.

The Internal Audit Department has completed a follow-up review of the Audit of Health Insurance Operations issued in November 2020. We conducted this performance audit 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.

Management Responsibility

City management is responsible for ensuring that resources are managed properly and used in compliance with laws and regulations; programs are achieving their objectives; and services are being provided efficiently, effectively, and economically.

Audit Objectives, Scope, and Methodology

This report is intended to provide a progress update on recommendations from the Audit of Health Insurance Operations (November 2020), which evaluated the City's health insurance operations including benefits plan management, participant enrollment, and claims administration.

Audit fieldwork was conducted during March, April, and May 2022. The scope of review varied depending on the procedure being performed. The following list summarizes major procedures performed during this time:

➢ Reviewed documentation from the issued audit to develop criteria including industry standards, best practices, policies, and procedures;

➢ Interviewed Risk Management Division staff;

➢ Reviewed Health Fund Reconciliation Procedure Manual, 2020 and 2021 Third-Party Administrator Performance Guarantee Reports, 2021 Third-Party

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[1] The City of Denton's Internal Audit Department is considered structurally independent as defined by generally accepted government auditing standard 3.56.

Administrator Service Organization Control Report, and Healthcare Claims Audit Report;

➢ Verified that a sample of Third-Party Administrator payments were authorized in accordance with City policy; and

➢ Observed annual dependent eligibility attestation statement.

Recommendation Status Update

This report summarizes the Audit of Health Insurance Operation's recommendations, management responses, and the Internal Audit Department's follow-up findings, which describe to what extent City management has implemented Internal Audit's recommendations since the publication of the original report in November 2020.

Medical Benefits Plans are Appropriately Monitored for Compliance & Utilization

The original <u>Audit of Health Insurance Operations</u> found that the City had established effective monitoring procedures to ensure its health insurance plan was adequately utilized and had access to resources that provided assurance that the City complies with all applicable regulations – including its fiduciary duty. For these reasons no recommendations were issued for this section. As such, this was not reevaluated as part of this follow-up review.

Plan Enrollment is Adequately Managed; Dependent Monitoring Could Lower Costs

1. **Develop and formalize a process for periodically identifying and removing ineligible dependents who are not removed by employees in a timely manner. It may be appropriate to focus these monitoring efforts on spouses and stepchildren who are at a higher risk of becoming ineligible than other dependents.**

    Management Response: Concur
    The Risk Management department concurs. Because the City relies on the employee to notify when a change in familial status occurs annually within six months of the close of open enrollment, a report will be run to identify dependents who are on the Plan. A sample of the dependents will be identified, and dependents' eligibility will be verified through a review of eligibility documents previously provided and by contacting the employee to verify that the dependent is still eligible to be on the Plan.

    Audit Follow-Up Finding: Implemented
    As part of the annual benefits enrollment process, employees are required to attest that all dependents covered on their benefits plan meet the City's eligibility requirements. In addition, the City requires that employees submit documentation whenever dependent coverage changes are made so that their eligibility can be verified. Dependent eligibility requirements are readily available on the City's internal website.

Claim Administration Controls Appear Adequate but Should be Regularly Reviewed

2. **Periodically conduct a review of adjudicated health insurance claims to verify plan implementation and identify claim processing errors. Best practices suggest that the period between Third-Party Administrator audits be based on previous audit results and changes to the benefits plan design. In addition, performance guarantees could be verified as part of this process.**

    Management Response: Concur
    The Risk Management department concurs with this recommendation. In response to this recommendation, the Risk and Compliance Manager has requested price quotes for an external claims audit. When quotes are received, a determination will be made regarding funds availability in this year's budget.

    Audit Follow-Up Finding: Implemented
    The City contracted with a vendor to perform an external healthcare claims audit for the period of January 1, 2020 through December 31, 2020. Based on review of the draft audit report, the review appeared to have evaluated issues such as eligibility, cost control, fraud/waste/abuse, other party liability, plan design, and industry standards using a judgement sample approach.

    In general, the audit found that the City should work with the Third-Party Administrator to clarify plan intent as some benefits were being processed outside of the City's Summary Plan Description. In addition, the audit identified some instances where plan benefits and industry standards had been implemented incorrectly resulting in some over and underpayments. Further details regarding the audit of healthcare claims can be shared by the Risk Management Division.

    The City's Third-Party Administrator has provided a detailed response to each of the audit's findings. According to Risk Management staff, they plan to contract with a vendor to perform a healthcare claims audit of the City's Third-Party Administrator every two years going forward.

3. **Develop a process to report to City Management any control weaknesses identified in the Third-Party Administrator's Service Organization Control Report. If weaknesses are identified, City Management should develop a plan to appropriately address these weaknesses.**

    Management Response: Concur
    The Risk Management department concurs with this recommendation. The department obtained the current report during the audit process and

requested that moving forward, McGriff provide the report on an annual basis as part of our Plan mid-year review. At the mid-year review, the report will be reviewed, and we will work with McGriff and the TPA to address any areas of concern. Should any areas of concern be identified, the Risk and Compliance Manager will notify City leadership about the concerns and the processes put in place to address the concerns on an ongoing basis.

Audit Follow-Up Finding: In Progress

According to Risk Management staff, the Third-Party Administrator's Service Organization Control Report was not requested for the 2020 plan year due to an administrative error. As part of the audit follow-up review, Risk Management staff requested the 2021 Service Organization Control Report be provided. In addition, Risk Management plans to meet with the City's Employe Benefits Consultant annually in the future to review the Service Organization Control Report.

Based on Internal Audit's review of this report, the Third-Party Administrator's independent auditor opined that internal controls were suitably designed and operating effectively to provide reasonable assurance that the control objectives were achieved if complementary user entity controls operated effectively.

While no control weaknesses were identified in the 2021 Service Organization Control Report, regular review of the Service Organization Control Report provides further assurance that the City is able to quickly identify any material control weaknesses or exceptions that could increase the risk of errors or irregularities when adjudicating claims.

4. **Annually verify that the City has adequate complementary user organization controls based on the Third-Party Administrator's Service Organization Control Report.**

Management Response: Concur
The Risk Management department concurs with this recommendation. Based on the SOC report received and reviewed at our Plan mid-year review as described above, the department will review and work with McGriff and the TPA to put in place any additional complementary controls needed to address any concerns.

Audit Follow-Up Finding: In Progress

According to Risk Management staff, they did not request the 2020 Service Organization Control Report from the Third-Party Administrator. Based on review of the 2021 Service Organization Control Report, the City appears to have improved the adequacy of its complementary user controls as shown in Table 1:

Table 1: Complementary User Controls Assessment

Recommended Control	Assessment Result[2]
The user's customer benefit plan is complete, authorized, and furnished to United Healthcare promptly.	Adequate (Original Audit)
Enrollment files are complete, accurate, and timely when submitted.	Adequate (Original Audit)
Only authorized users have access to the United Healthcare information available on the eServices Portal.	Adequate (Follow-Up Review)
Available claim payment funds are authorized.	Adequate (Follow-Up Review)
Claim charges are funded completely and timely.	Adequate (Original Audit)
User reconciles monthly invoices using the number of enrollees and contracted rates.	Adequate (Original Audit)
Relevant financial performance reports are obtained and used appropriately.	Adequate (Original Audit)
User completes any needed actuarial analysis.	Not Reviewed[3]

While the City now appears to have adequate complementary user controls, regular evaluation of these by the Risk Management Division would increase assurance that claims are processed efficiently and further demonstrate the City's commitment to fulfilling its fiduciary duty.

5. **Periodically request the Third-Party Administrator provide a list of individuals who have access to the City's eServices Internet Portal and verify that only authorized individuals are included.**

Management Response: Concur
The Risk Management department concurs with this recommendation. The Benefits Supervisor will request a user report from the TPA at the end of each Plan Year and when an employee begins work with the Benefits Team (on a temporary or permanent basis) to ensure only authorized individuals are permitted access to the employer services portal. Additionally, when any team member departs the Benefits Team, the Benefits Supervisor will ensure the team member's access is removed on or before their last day with the team.

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[2] Assessment results are generally detailed in the original Audit of Health Insurance Operations (pdf) or other sections of this follow-up report.

[3] According to Risk Management staff, the City's Employee Benefits Consultant conducts actuarial analysis as needed; however, this analysis was not examined as part of the original audit or this follow-up review.

Audit Follow-Up Finding: Implemented
The Risk Management Division has developed a process to annually request the list of individuals with access to the eServices Internet Portal to verify that only authorized individuals are included. According to Division staff, no changes were made based on these verifications during 2021 or 2022.

Claims Funding Process Should be Clarified

6.   **Clarify the weekly health insurance claim funding reconciliation process in consultation with the Finance Department. This documentation should clearly identify roles and responsibilities in the process as well as clarify funding authority levels.**

Management Response: Concur
The Risk Management department concurs with this recommendation. The Benefits Team has the claims funding reconciliation process documented up to the point where the process transitions to the Finance department. The Benefits Supervisor and Benefits and HRIS Specialist will work with Finance to document the full process in one complete document.

Audit Follow-Up Finding: Implemented
The Risk Management Division has developed and implemented a standard operating procedure detailing the claim funding reconciliation process. This standard operating procedure assigns the claim funding authorization authority to the Deputy Director of Risk & Compliance for all health insurance claim funding transfers regardless of monetary value.

Based on review of a judgement sample of ten claim funding confirmation forms, all were approved in accordance with the adopted standard operating procedure.

Periodic Verification of the TPA's Performance Would Increase Assurance

7.   **Implement monitoring procedures for performance guarantees. The City staff should also ensure that United Healthcare duly pays the penalties for non-performance, if any, relating to claims processing and other agreed performance guarantees.**

Management Response: Concur

The Risk Management department concurs with this recommendation. The Risk Management department will request that McGriff provide the Performance Guarantee report annually as part of our Plan year-end review. Upon review of the report, we will work with McGriff and the TPA to address any concerns.

Audit Follow-Up Finding: Implemented
According to Risk Management Division staff, the 2020 plan year performance guarantee was received and reviewed in June 2021. In addition, the 2021 plan year performance guarantee was received based on Internal Audit's request in March 2022; however, according to the Third-Party Administrator, this report is not typically ready till June.

Based on review of the performance guarantee reports, the Third-Party Administrator met all performance guarantees for 2020 and met all but one performance guarantee for 2021. The non-compliant performance guarantee was due to the average speed to answer a customer's phone call being about 8 seconds slower than the 30 second goal. This non-compliance resulted in a credit to the City of $8,800, which was appropriately credited to the City in April 2022. It should be noted that the Performance Guarantee Results are self-reported by the Third-Party Administrator.

City of Denton

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215 E. McKinney St.
Denton, Texas 76201
www.cityofdenton.com

Legislation Text

File #: IAAC24-013, **Version:** 1

AGENDA CAPTION

Management Reports:
1. City Auditor's Office Fiscal Year 2023-24 Second Quarter Report
2. Fiscal Year 2022-23 Informal Follow-Up Review Report

MEMORANDUM

DATE: April 29, 2024

TO: Internal Audit Advisory Committee

FROM: Madison Rorschach, City Auditor

SUBJECT: Fiscal Year 2023-24 Second Quarter Performance Report

FY23-24 Annual Internal Audit Plan Status

Audit Project Status – The following table summarizes the status of each audit project included in the fiscal year 2023-24 Annual Internal Audit Plan at the end of the second quarter. About 41 percent of the time budgeted for audit projects had been used by the end of the second quarter.

Table 1: FY23-24 Audit Project Status As of 03/31/24

Audit Project	Status	Hours Budgeted	Hour Actuals
Overflow: Staff Recruiting & Hiring	Closed	500	670
Public Safety Communications	Closed	500	325
Community Housing Initiatives	Fieldwork	500	215
Franchise Fees	Reporting	450	117
Electric System Operations	Fieldwork	600	358
Vendor Management	Planning	500	6
Development Planning	Hold	500	0
Park Management & Planning	Hold	500	0
New Audit Project Totals:		4,050	1,691
Meter Reading & Billing: Electric & Water Utilities	Closed	25	50
Water System Operations	Closed	75	91
Informal Follow-Up Review	Fieldwork	50	26
Payroll Administration	Hold	25	0
Fleet Services Operations	Hold	50	0
Police Property Room	Hold	50	0
Emergency Medical Services: Ambulance Billing	Hold	25	0
Follow-Up Review Totals:		300	167
All Audit Projects:		4,350	1,858

New Audit Projects Released – One new audit report including 17 recommendations was issued during this period. Results from these reports are summarized below:

Table 2: Released New Audit Report Summary

Project	Recs.	Agreement	Published
Staff Recruiting and Hiring	17	71%	Mar. 5, 2024

215 E. McKinney St., Denton, TX 76201 • (940) 349-7228

New Follow-Up Reviews Released – No follow-up review reports were issued during this period.

Post-Audit Feedback Survey Results – Based on the one audit project report issued during the second quarter of fiscal year 2023-24, the Internal Audit Division's services were rated 5.00 out of five stars by the auditee department's staff.

Avg. Q2 Internal Audit Service Rating: ⭐ ⭐ ⭐ ⭐ ⭐

Ad-Hoc Project Updates – The City Auditor's Office completed the following Consultation projects during the second quarter of fiscal year 2023-24:

➢ Nine advice requests from the Finance, Procurement, Human Resources Departments, and Denton Municipal Electric;

➢ Six assistance requests from the City Manager's Office, Strategic Services and Finance departments, and the City Council;

➢ Four new anonymous fraud, waste, and abuse reports were submitted. Per City Policy 509.01 "Fraud Response," these submissions were reviewed by the Investigation Committee. One case was closed without investigation, one case was forwarded to Human Resources for review, one was forwarded to the Building Inspections Division, and one case was reported to Human Resources after preliminary review by the City Auditor's Office.

One analysis project to conduct a cultural assessment of a specific department was performed based on a request from the Human Resources Department. In addition, the City Council requested assistance with developing a procedure for processing complaints received for City Council appointees.

Follow-Up Review Monitoring

Outstanding Recommendations – At the end of the second quarter of Fiscal Year 2023-24, the Internal Audit Division has issued 446 recommendations and has formally completed five audit projects that included 51 recommendations. In addition, four audit projects including 37 recommendations are ready to be considered for completion. Figure 1 shows the current pace of audit recommendation issuance and closure as well as the current follow-up status of audit recommendations by fiscal year issued.

Follow-Up Review Pace Update – The City Auditor's Office's goal is to have followed up on at least 30 percent of outstanding recommendations to initially follow up on audit reports within 27 months of issuance on average. Practically, this means that the Division has planned to perform at least six follow-up reviews annually between 18 to 36 months after each initial audit was issued.

Currently, the Division has performed follow-up work on about 39 percent of outstanding recommendations; however, the average time before an initial follow-up review is published has begun increasing and is currently averaging just under 30 months.

Figure 1: Audit Recommendation Status by Fiscal Year[1]
(As of March 31, 2024)
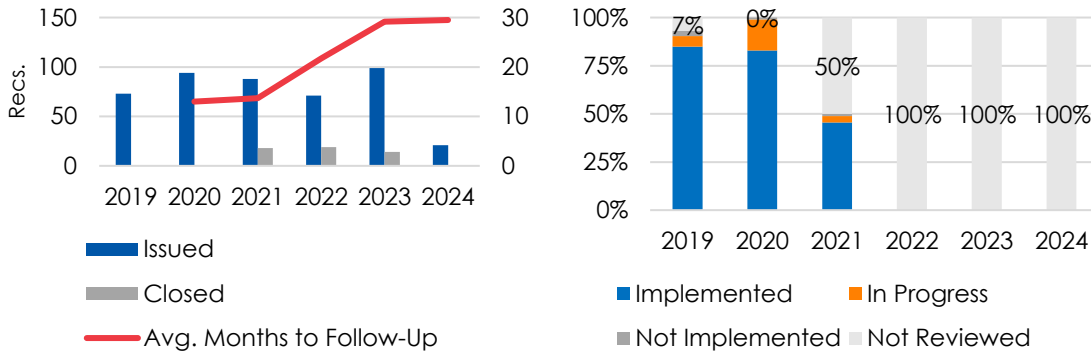
Public Engagement Update

Website Metrics – During the second quarter of Fiscal Year 2023-24, the City Auditor's Office released one news flash covering a new audit report, which drew an average of 55 views to the Audit Reports page. In addition, news flash subscribers continued to steadily grow by one subscription a month. Figure 2 illustrates website engagement during Fiscal Year 2024 so far; news flash subscribers have grown by about 17 percent and Audit Report webpage views averaged around 53.

Figure 2: Fiscal Year 2024 City Auditor's Office Website Metrics

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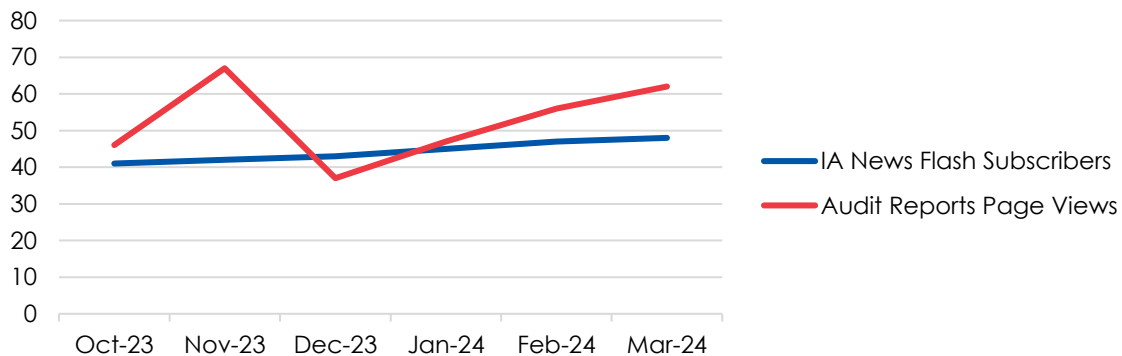
[1] No follow-up reviews were performed in Fiscal Year 2019 or 2020 as they were the first two years recommendations were issued by the City Auditor's Office after it was reformed in 2017.

Fiscal Year 2024-25 Preliminary Budget

According to best practices, audit committees may make recommendations to the governing body regarding the audit function's budget. For this reason, the City Auditor's Office is presenting the Department's preliminary fiscal year 2024-25 budget. Table 3 summarizes the Department's budget and its expenses over the last few years:

Table 3: 2023 Training & Development Program Costs

Expense	FY22-23 Actual	FY23-24 Estimate[2]	FY24-25 Prelim. Budget
Personnel Services	$452,750	$553,380	$690,000
Operations			
External Audit	$113,300	$123,500	$130,000
Board of Ethics	$2,790	$3,000	$3,000
Licenses & Dues	$2,980	$5,500	$6,800
Employee Reporting Hotline	$1,800	$1,800	$1,800
Travel & Training	$5,860	$8,000	$12,000
Community Outreach	$1,050	$1,000	$1,000
Peer Review	$0	$0	$3,000
Materials & Supplies	$420	$2,240	$3,000
Interfund Transfers	$33,850	$44,540	$44,540
Total:	**$614,800**	**$742,960**	**$895,140**

The preliminary fiscal year 2024-25 budget for the City Auditor's Office includes a proposed Staff Auditor position and an increase in associated costs such as dues, licensing, travel, and training. In addition, it includes an increase in the annual external audit cost and a one-time amount for a peer review of the Department. A peer review must be performed every three years to comply with *Generally Accepted Government Auditing Standards*. The Department received the highest opinion possible for its first peer review, which was completed in 2022 for Fiscal Years 2019-2021.

Other Items of Note

Compliance Program – The Compliance Specialist position was filled in January 2024 and the first comprehensive compliance report covering the City's financial activities during Fiscal Year 2023-24 Quarter One is currently being drafted.

Attachments

1. Second Quarter Time Utilization Report
2. Fiscal Year 2023-24 City Auditor's Office Tentative Project Schedule

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[2] Theses estimates were made by the City Auditor's Office and are not the official estimates of the Finance Department.
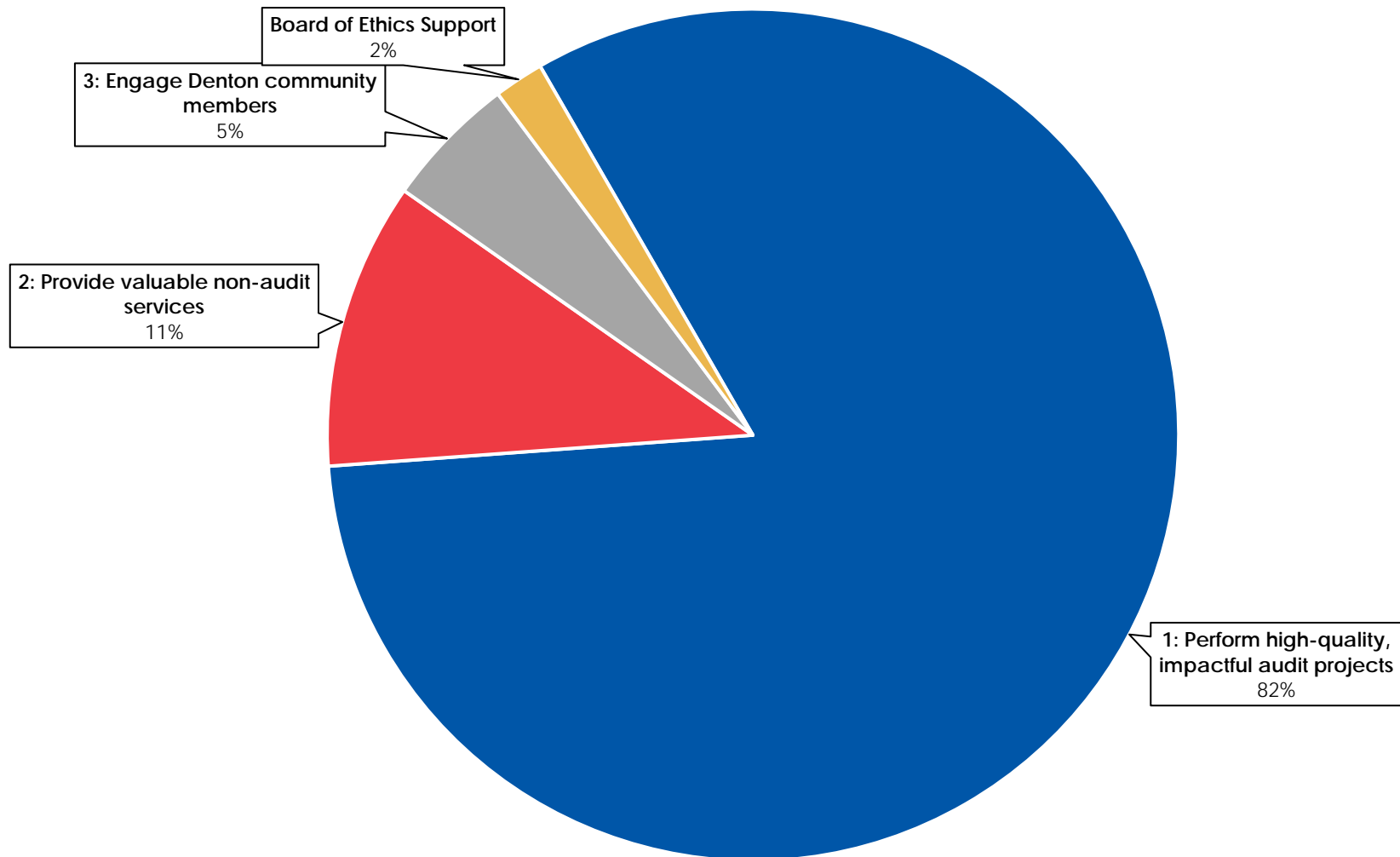
FY 2022-24 Annual Time Utilization Report
As of Quarter Two

Program	Quarter 1 Time	Quarter 1 Cost	Quarter 2 Time	Quarter 2 Cost	Quarter Time	Quarter Cost	Quarter 4 Time	Quarter 4 Cost	Year to Date Time	Year to Date Cost
New Audit Projects	715.75	$29,083	842.00	$35,169					1,557.75	$64,252
Training & Development	113.25	$5,917	200.50	$9,067					313.75	$14,984
Audit Follow-Up Reviews	133.75	$6,440	9.25	$495					143.00	$6,935
Non-Audit Services	19.25	$1,201	60.25	$4,154					79.50	$5,355
Board of Ethics Support	25.75	$1,807	20.50	$1,439					46.25	$3,246
Anti-Fraud Activities	0.50	$35	11.75	$796					12.25	$831
Performance Reporting	61.50	$3,249	55.00	$3,107					116.50	$6,356
Community Outreach	7.25	$509	0.25	$18					7.50	$526
Compliance	31.00	$2,176	144.25	$4,928					175.25	$7,104
Total:	1,108.00	$50,417	1,343.75	$59,172	0.00	$0	0.00	$0.00	2,451.75	$109,590

FY 2023-24 Time Utilization by Strategy
(As of Quarter 2)

Board of Ethics Support
2%

3: Engage Denton community
members
5%

2: Provide valuable non-audit
services
11%

1: Perform high-quality,
impactful audit projects
82%

City Auditor's Office FY23-24 Tentative Schedule
(April 23, 2024)

Color	Project Type
Purple	New Audit Projects
Blue	Follow-Up Audit Projects
Green	Consultation Projects
Yellow	Compliance Projects
Orange	Administrative Projects

October – March

	October			November			December			January			February			March		
	Beg.	Mid.	End.	Beg.	Mid.	End.	Beg.	Mid.	End.	Beg.	Mid.	End.	Beg.	Mid.	End.	Beg.	Mid.	End.

New Audit Proj.
- 036 Public Safety Communications (Oct Beg. – Dec Mid.)
- 037 Community Housing Initiatives (Dec End. – March End.)
- 038 Franchise Fees (Dec Beg. – March End.)
- 035 Recruit & Hire (Oct Beg. – March Mid.)
- 039 Electric System Operations (Jan Beg. – March End.)

Other Proj.
- 017 Meter Reading (Oct Beg. – Nov Mid.)
- 2024 Informal Follow-Up Review (Jan Beg. – March End.)
- 021 Water System Operations (Oct Beg. – Nov Mid.)
- FY24 Q1 Vendor Mgmt. Compliance Review (Jan Beg. – March End.)
- Facilities Access (Jan Beg. – Feb Beg.)
- Trailers & Attch. Inv. (March Beg. – March End.)
- Culture Assmt. (Jan Mid. – Feb Beg.)
- Appointee Process (March Beg. – March End.)

April – September

	April			May			June			July			August			September		
	Beg.	Mid.	End.	Beg.	Mid.	End.	Beg.	Mid.	End.	Beg.	Mid.	End.	Beg.	Mid.	End.	Beg.	Mid.	End.

New Audit Proj.
- 037 Community Housing (April Beg. – June Mid.)
- 042 Park Management & Planning (June End. – Sept Beg.)
- 038 (April Beg. – April Mid.)
- 041 Development Planning (May End. – Aug Beg.)
- 040 Vendor Management (April Beg. – June End.)
- 039 Electric (April Beg. – June Mid.)

Other Proj.
- 023 Payroll Administration (April End. – June End.)
- Fuel Cards (July Beg. – July End.)
- 004 Police Prop. Room (Aug Beg. – Sept End.)
- 032 Fleet Services Operations (May End. – July End.)
- 024 EMS: Ambulance Billing (Aug Beg. – Sept End.)
- Journal Entry (April Beg. – April End.)
- Def. Driving (June Beg. – June End.)
- Audit Plan Dev. (July Beg. – July End.)
- Cash Handling (Sept Beg. – Sept End.)
- FY24 Q2 Vendor Mgmt. Compliance Review (April Beg. – June End.)
- FY24 Q3 Vendor Mgmt. Compliance Review (July Beg. – Sept End.)

INFORMAL STAFF REPORT
TO MAYOR AND CITY COUNCIL

SUBJECT:
Fiscal Year 2022-23 Internal Audit Informal Follow-Up Review Report

BACKGROUND:
The Internal Audit Department has completed informal follow-up reviews of the audit projects listed below. We conducted this performance audit per 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.

Previously, the Internal Audit Department has completed formal follow-up reviews of the following audit projects and found that only one or two recommendations were outstanding:
    Project 001 – Audit of Customer Service Division;
    Project 006 – Audit of Roadway Quality Management;
    Project 010 – Audit of Capital Projects Administration: Property Acquisition; and
    Project 018 – Audit of Health Insurance Operations.

This report is intended to provide an update on the six outstanding recommendations from each of these projects. Audit fieldwork was conducted during January, February, March, May and July 2023. The scope of the review varied depending on the procedure being performed. The following list summarizes major procedures performed during this time:
- Reviewed documentation from the issued audit and follow-up reports relevant to the six outstanding recommendations;
- Examined account history of the five outstanding accounts noted in the Audit of Customer Service Division and discussed current account status with the Customer Service Division, and the Finance and Legal Departments' staff;
- Reviewed Street Division standard operating procedures related to identifying, reviewing, and approving street maintenance activities and selecting street rehabilitation design standards;
- Observed a judgement sample of street maintenance selection and approval documentation and street maintenance inspections;
- Reviewed a sample of 18 parcels acquired between March 2022 and January 2023 for capital improvement projects; and
- Reviewed communication between the City's Human Resources Department and Third-Party Administrator regarding the Service Organization Control Report and user access list.

City management is responsible for ensuring that resources are managed properly and used in compliance with laws and regulations; programs are achieving their objectives; and services are being provided efficiently, effectively, and economically.

DISCUSSION:
Project 001 – Audit of Customer Service Division
Previously, the Internal Audit Department completed a follow-up review of the Audit of Customer Service Division in June 2020. At that time, Staff found that 14 of the issued 15 recommendations had been implemented. The remaining recommendation and its follow-up results are shown below:

15. The City Attorney and Finance Director need to collaborate to pursue collection on the above four accounts and the Company 5 account.

    Management Response: Concur
    The Finance Director will continue to consult with the City Attorney's Office regarding collection options for these large receivables and follow up with the Internal Auditor once a collection option is identified.

    Audit Follow-Up Finding: Implemented
    The original audit had identified five companies that had large outstanding receivable balances that were not being pursued by the Customer Service Division at the time. Table 1 compares the original outstanding balances identified in the audit to the balance as of January 2023 and summarizes the account's current status.

Table 1: Outstanding Commercial Receivables (January 2023)

Company Reference	Status	Original Audit Balance	Current Balance
Company 5	Bankruptcy	$977,446	$977,446
Company 1	Bankruptcy	$206,299	$391,040
Company 2	Collections	$187,639	$131,493
Company 3	Paid	$34,132	$83
Company 4	Paid	$24,050	$0
	Total:	$1,429,566	$1,500,062

The balances of Company 5 and Company 1 are being collected by the City through the bankruptcy process that these companies are currently undergoing. Finally, for Company 2, the balance has been sent to the Customer Service Division's contracted collections agency per adopted standard operating procedures. Based on this information, this recommendation appears to be implemented to the extent possible.

Project 006 – Audit of Roadway Quality Management
Previously, the Internal Audit Department completed a follow-up review of the Audit of Roadway Quality Management in October 2021. At that time, Staff found that ten of the issued 12 recommendations had been implemented. The remaining recommendations and their follow-up results are shown below:

1. Develop a standardized process for recording/approving street rehabilitation design adjustments.
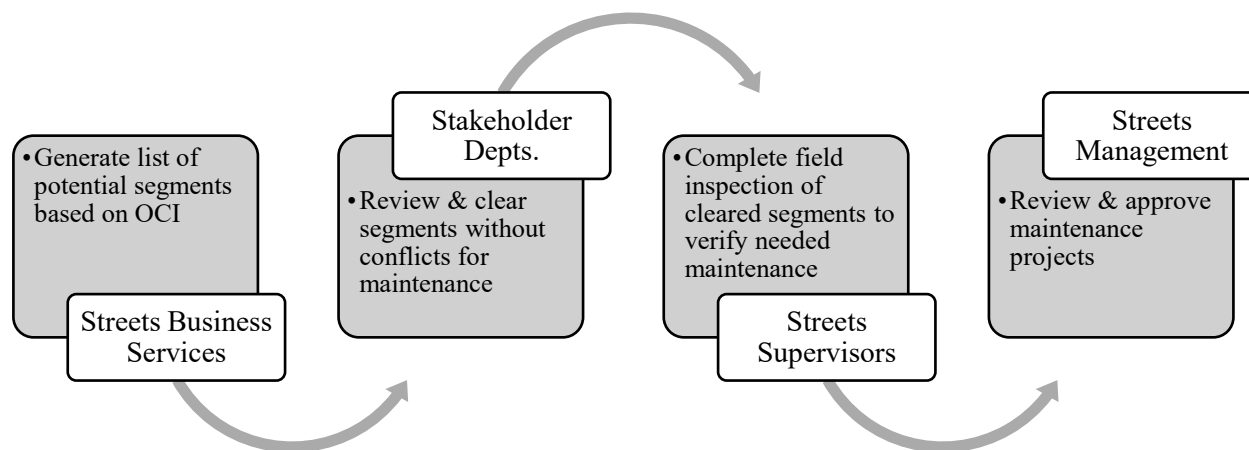
Management Response: Concur
Staff will implement process controls for deviation from recommendations. This will include written documentation escalated and signed by management to approve the deviation. SOPs (standard operating procedures) will be created and all employees will be trained on the process.

Audit Follow-Up Finding: Implemented
The original audit found that some street maintenance activities did not align with the recommended activity based on the overall condition index – or OCI – score of the relevant street segment. Further, the reason for performing these unaligned maintenance activities was not documented or approved by Streets Management.

In January 2023, the Streets Division implemented a standard operating procedure that outlined the process for selecting and approving street maintenance activities as illustrated in Figure 1. Based on a review of a sample maintenance project approved in February 2023, this procedure appears to be in effect indicating this recommendation is implemented.

Figure 1: Street Maintenance Project Selection & Approval Process

3. Require Street Field Supervisors to submit periodic inspection reports.

Management Response: Concur
Standardized inspection documentation will be created and implemented. These documents will be specific to the work being performed, (mill and overlay, micro seal, reconstruction, etc.), archived in the Cartegraph system, and tied to the work order. SOPs (standardized operating procedures) will be created and all employees will be trained.

Audit Follow-Up Finding: Implemented
During the original audit, Streets staff stated that inspections of in-house street maintenance projects – including micro sealing, mill and overlays, and reconstructions – were performed by the City's Streets Supervisors; however, no documentation of completed inspection results was produced. Since then, Streets has worked with the City's Public Works Inspections Department to develop standard checklists for asphalt paving and roadway subgrade lime

stabilization activities. Based on a review of two sample maintenance projects performed during April 2023, these inspection checklists were generally completed by a Streets Field Services Supervisor and reviewed by a Public Works Inspector indicating this recommendation is implemented.

Project 010 – Audit of Capital Projects Administration: Property Acquisition
Previously, the Internal Audit Department completed a follow-up review of the Audit of Capital Projects Administration: Property Acquisition in April 2022. At that time, Staff found that four of the issued five recommendations had been implemented. The remaining recommendation and its follow-up results are shown below:

1. Require Real Estate Staff to execute and maintain all required documents properly for the acquisition of real estate properties in line with implemented real estate acquisition process.

   Management Response: Concur
   Direction to execute and maintain documents had previously been given prior to audit. Steps have been implemented to check/confirm compliance monthly.

   Audit Follow-Up Finding: Implemented
   In general, the City's real estate acquisition process requires the department to create and acquire the following critical documents:

   - Project Request Form
   - Property Appraisal
   - Counteroffer Justification
   - Project Introduction Letter
   - Initial Offer
   - Payment Verification
   - Title Commitment
   - Final Offer
   - Recording Instrument

   The original audit and the first follow-up review found that critical property acquisition documentation from some projects was not available. Most notably, some title commitments and offer letters were not available and the original audit found that there was no requirement for acceptance of a counteroffer to be justified. Based on a review of 28 parcels acquired between March 2022 and January 2023, all required documentation was available indicating this recommendation is implemented as shown in Figure 2.

Figure 2: Missing Property Acquisition Documentation Comparison

183
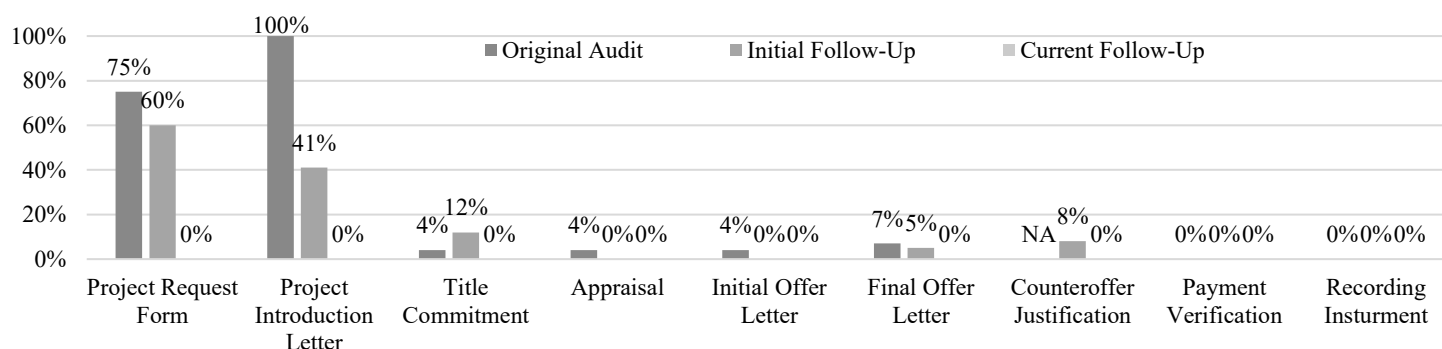
Project 018 – Audit of Health Insurance Operations

Previously, the Internal Audit Department completed a follow-up review of the Audit of Health Insurance Operations in June 2022. At that time, Staff found that five of the issued seven recommendations had been implemented. The remaining recommendations and their follow-up results are shown below:

3. Develop a process to report to City Management any control weaknesses identified in the Third-Party Administrator's Service Organization Control Report.

    Management Response: Concur
    The Risk Management department concurs with this recommendation. The department obtained the current report during the audit process and requested that moving forward, McGriff provide the report on an annual basis as part of our Plan mid-year review. At the mid-year review, the report will be reviewed, and we will work with McGriff and the TPA to address any areas of concern. Should any areas of concern be identified, the Risk and Compliance Manager will notify City leadership about the concerns and the processes put in place to address the concerns on an ongoing basis.

    Audit Follow-Up Finding: Implemented
    In general, the City's Third-Party Administrator for its health insurance plans is required to undergo an independent evaluation of their claim's administration process annually. The results of this evaluation are then communicated in a Service Organization Control – or SOC – report that describes the reviewed process, reports on any material control weaknesses, and recommends controls that user entities should employ in their organizations. The original audit found that the City's Third-Party Administrator was required to provide their annual SOC report to the City; however, this had not been regularly obtained and reviewed by City staff. Further, the first follow-up review found that a process had not been established to regularly request this report.

    Since then, a process to request this report has been developed and the report is discussed with the City's Employee Benefits Consultant annually. Based on this information, this recommendation appears to be implemented.

4. Annually verify that the City has adequate complementary user organization controls based on the Third-Party Administrator's Service Organization Control Report.

    Management Response: Concur
    The Risk Management department concurs with this recommendation. Based on the SOC report received and reviewed at our Plan mid-year review as described above, the department will review and work with McGriff and the TPA to put in place any additional complementary controls needed to address any concerns.

    Audit Follow-Up Finding: Implemented
    The original audit found that the City had not implemented all complementary user controls recommended by the SOC report; however, these had been implemented as of the completion of the first follow-up review. Based on this information, as well as the implementation of Recommendation 3, this recommendation appears to be implemented.

CONCLUSION:

Based on the information presented in the above Discussion section, the status of each recommendation is summarized below:

Recommendation	Mgmt. Response	Status
001 Audit of Customer Service Division		
15. Pursue collection of identified delinquent commercial accounts.	Concur	Implemented
006 Audit of Roadway Quality Management		
1. Develop a standardized process for recording/approving street rehabilitation design adjustments.	Concur	Implemented
3. Require Street Field Supervisors to submit periodic inspection reports.	Concur	Implemented
010 Audit of Capital Improvement Projects: Property Acquisition		
1. Require Real Estate staff to execute and maintain all required documents properly for the acquisition of real estate properties in line with implemented real estate acquisition process.	Concur	Implemented
018 Audit of Health Insurance Operations		
3. Develop a process to report to City Management any control weaknesses identified in the Third-Party Administrator's Service Organization Control Report.	Concur	Implemented
4. Annually verify that the City has adequate complementary user organization controls based on the Third-Party Administrator's Service Organization Control Report.	Concur	Implemented

Based on the results of this informal follow-up review, Staff is recommending the following:

- Project 001 – Customer Service Division be closed and considered formally complete with a 100% Implementation rate;
- Project 006 Roadway Quality Management be closed and considered formally complete with a 100% Implementation rate;
- Project 010 Capital Projects Administration: Property Acquisition be closed and considered formally complete with a 100% Implementation rate; and
- Project 018 Health Insurance Operations be closed and considered formally complete with a 100% Implementation rate.

These recommendations will be presented to the Internal Audit Advisory Committee for review and necessary action. If the City Council has any concerns about the above Staff recommendations, please reach out to the City Auditor before June 23, 2023.

ATTACHMENTS:
None.

STAFF CONTACT:
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Internal Audit Department
(940) 349-7228
Madison.Rorschach@CityofDenton.com

REQUESTOR:
Staff Initiated

PARTICIPATING DEPARTMENTS:
Internal Audit, Customer Service, Streets, Real Estate, Human Resources

STAFF TIME TO COMPLETE REPORT:
22 Hours (Internal Audit only)