



**OFFICE OF THE CITY CONTROLLER
OPERATIONS DIVISION
CONTRACT CERTIFICATION AND PAYROLL CONTROL
PROCESS REVIEW
SEPTEMBER 1999**

Sylvia R. Garcia, City Controller

Judy Gray Johnson, Chief Deputy City Controller

Steve Schoonover, City Auditor



OFFICE OF THE CITY CONTROLLER
CITY OF HOUSTON
TEXAS

SYLVIA R. GARCIA

December 20, 1999

The Honorable Lee P. Brown, Mayor
City of Houston, Texas

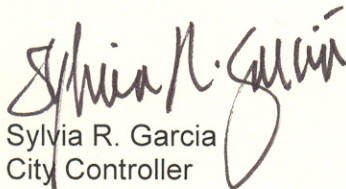
SUBJECT: Office of the City Controller
Operations Division – Contract Certification and Payroll Control Process Review
(Report No. 99-09)

Dear Mayor Brown:

In accordance with the City's contract with McConnell, Jones, Lanier, and Murphy (MJLM), MJLM has completed a Contract Certification and Payroll Control Process Review within the Operations Division (Division) of the Office of the City Controller.

MJLM designed the review to include an assessment of the efficiency and effectiveness of Request for Council Action certification procedures, payroll control procedures, related internal controls, processes, staffing, and technological capabilities. Their report, attached for your review, commended the Division for noteworthy practices. However, recommendations were made that should help the Division make incremental improvements in the certification and payroll control processes to improve efficiency and effectiveness, reduce turnaround time, and enhance internal controls. The findings and recommendations are presented in the body of the report and the views of the responsible officials are appended to the report as Exhibit I.

Respectfully submitted,


Sylvia R. Garcia
City Controller

xc: City Council Members
Albert E. Haines, Chief Administrative Officer
Sara Culbreth, Acting Director, Finance and Administration Department



McCONNELL JONES LANIER & MURPHY^{LLP}
CONSULTANTS & BUSINESS ADVISORS

November 24, 1999

The Honorable Sylvia R. Garcia
Controller
City of Houston
901 Bagby, 8th Floor
Houston, Texas 77002

Dear Controller Garcia:

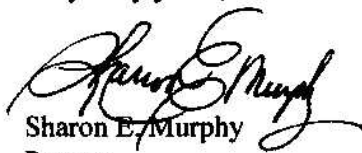
I am pleased to present the *Final Report* for the Office of the City Controller, Operations Division (Operations Division), Contract Certification and Payroll Control Process Review completed by McConnell, Jones, Lanier & Murphy LLP on September 15, 1999.

The objectives of the process review were to assess the efficiency and effectiveness of Request for Council Action (RCA) certification procedures, related internal controls, processes, staffing, and technological capabilities; determine the necessary procedures and controls required to achieve realistic turnaround (in number of days) of RCA certifications; evaluate existing databases for potential improvements; and review existing payroll control procedures and related staffing, and determine the effect on operations of eliminating one full-time equivalent position in the Payroll Control Section.

Although we have made recommendations to improve certification and payroll control processes and related internal controls, we have also commended the Operations Division for noteworthy practices. This report will help the Operations Division make incremental improvements in the certification and payroll control processes to improve efficiency and effectiveness, reduce turnaround time, and enhance internal controls.

We are grateful for the cooperation of the Operations Division's management team and employees during the process review. We are especially grateful to director of the Operations Division, who served as our liaison and point of contact during the engagement.

Very truly yours,


Sharon E. Murphy
Partner

**OFFICE OF THE CITY CONTROLLER
OPERATIONS DIVISION**

**Contract Certification and Payroll Control
Process Review**

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CONTRACT CERTIFICATION AND PAYROLL CONTROL OVERVIEW

The City of Houston Controller (Controller) commissioned reviews of the Contract Certification (i.e., Request for Council Action) and Payroll Control processes for its Operations Division. For the Request for Council Action (RCA) processes, the firm of McConnell, Jones, Lanier & Murphy LLP (MJLM) was required to focus on improving certification procedures and related internal controls. The primary objectives of the review were to:

- Assess the efficiency and effectiveness of RCA certification procedures, related internal controls, processes, staffing, and technological capabilities.
- Determine the necessary procedures and controls to achieve a realistic turnaround time (number of days) for RCA certifications.
- Evaluate existing databases for potential improvements.

For the Payroll Control process, MJLM was required to review existing payroll control procedures, study related staffing issues, and determine the effect on operations of eliminating one full-time equivalent position in the Payroll Control section.

Request for Council Action (RCA) – Major Findings, Commendations, and Recommendations

Commendation - The Funds Certification staff has managed a high level of change effectively. Over the past three years, a new Controller has been elected, a new financial accounting system has been installed, and RCA volume has remained at a high level. At the same time, many of the departmental personnel interviewed indicated that the Funds Certification staff have been responsive to their needs. Also, the review team observed the positive team spirit and leadership displayed by the Funds Certification staff while they assisted department personnel with the new financial accounting system.

FINDING/RECOMMENDATION

Based on Charter requirements, the Controller's primary responsibilities related to Funds Certification are to certify that either (1) funds are available to meet expenditure obligations or (2) funds will be available before the maturity of the obligation. Based on the review team's analysis of Funds Certification procedures and interviews with staff, current certification procedures followed by staff exceed the Charter requirements. For example, Funds Certification staff members perform a review for the provision granting the City the right to audit contractor's books and records and for the monetary unit of payment, such as hourly or flat rate. These reviews are performed to provide assistance to the Legal department. Based on interviews with the staff, standard language is not used in the contracts, making it difficult to find these provisions.

Discontinue the review for contract provisions that grant the City the right to audit contractor's books and records and for review of monetary unit of payment such as hourly or flat rate.

FINDING/RECOMMENDATION

Funds Certification staff members perform redundant procedures, including:

- Photocopying the ordinance summary sheet and placing an ink imprint block that contains information that is already included on both the RCA and requisition document.
- Affixing multiple approval signatures to the RCA and extending the length of time required to process RCAs.

Eliminate the ink imprint information and the requirement for the signature of the Deputy Controller.

FINDING/RECOMMENDATION

The Funds Certification staff issues electronic approval to requisitions received from departments. Since electronic approval has not been granted to departments at the time requisitions are prepared, Financial Management System does not pre-encumber or obligate the requisitioned amount. Due to the timing difference of receipt and processing by the Funds Certification staff, other transactions that are not subject to the RCA process may be executed, creating insufficient funds problems for the RCA. Through interviews with Funds Certification staff and departmental personnel, MJLM learned that this is a frequent occurrence.

Assign departments electronic approval authority.

FINDING/RECOMMENDATION

The current threshold of \$5,000 is too low and results in a high volume of transactions that have minimal dollar risk in relation to the total dollar value of the RCA and City budgets.

Establish a higher dollar threshold for RCA transactions requiring Controller approval. Report transactions below the established threshold to Council for information purposes only.

FINDING/RECOMMENDATION

Historically, City departments have not effectively planned the use of their budget resources during the fiscal year or in instances where large projects overlap fiscal years. Based on an analysis of Funds Certification tracking log data, monthly volume peaks commonly occur in the last two months of the fiscal year. This shows that departments attempt to expend any unobligated funds prior to fiscal year-end close out. Since the Council adopts an ordinance appropriating funds before the start of the fiscal year, proper planning would entail acquisition of goods and services in the first quarter for use throughout the fiscal year. The same analysis shows a significant increase in transaction volume (in the middle of the fiscal year) in an instance where all funds were not expended on a large contract and a high number of RCAs were processed in order to expend remaining funds.

Distribute a memorandum to Finance and Administration describing the increased volume of transactions at year-end and the burden it imposes. Establish deadlines for processing RCAs for council agenda.

FINDING/RECOMMENDATION

The RCA Funds Certification process is manual, highly paper intensive, and disjointed. The RCA is a preprinted document without a numbering scheme. City departments initiate the RCA that is supported by bid proposals, contracts, agreements, grant applications, and ordinances. All of the supporting documentation is paper. These documents flow from the departments to Finance and Administration, Legal, Purchasing, the Controller, and the City Secretary via physical interoffice mail. Each department uses its own RCA numbering scheme. Many departments also maintain tracking logs on personal computers. These satellite-tracking systems are not uniform nor are they linked via a network infrastructure. Once RCA forms are received by the Controller, Funds Certification staff also assign a unique identifying number for tracking purposes. Like the departments, the Controller also maintains a separate tracking log.

Automate the RCA process to improve efficiency. Provide departmental access to imaging system in the short term. Develop a uniform client-server system as a permanent solution.

Payroll Control – Major Findings, Commendations, and Recommendations

Commendation - Payroll Control has continued to meet weekly payroll processing requirements even with the reduction of one staff position. Employees within the unit are dedicated to ensuring high accuracy levels related to internal control and certification functions.

FINDING/RECOMMENDATION

The City of Houston has two biweekly payrolls—the municipal payroll and the payroll for the Police and Fire Departments. An essential indicator for measuring operating efficiency and productivity for any function is accurate transaction volume indicators and statistics for output per employee. Manual logs for recording the number of transactions processed for each major audit function have been developed for Payroll Control, but these logs are not maintained consistently.

Record and maintain transaction volume for all major payroll control processing functions after each payroll cycle is completed; add monthly and year-to-date volume indicators; and, monitor the logs as a means of measuring exception volume and staff productivity.

FINDING/RECOMMENDATION

Payroll Control staff identifies exception-processing errors by manually scanning three reports that are generated by the City's Information Services Department. Exception errors could be identified more easily and a higher number of errors could be corrected if additional exception reports were developed that do a better job of isolating payroll transaction types that are likely to result in errors.

Work with the City's Information Services Division of the Finance and Administration Department to develop additional payroll control exception reports to facilitate more efficient processing.

FINDING/RECOMMENDATION

Payroll Control is responsible for auditing the accuracy of personnel action forms which involves confirming that an open and budgeted position is in place for new hires, rehires, promotions, and transfers. The review team identified two issues related to the 201 form audit process. First, Payroll Control does not track error rates or the dollar volume of errors identified during the audits. As a result the audits are not as effective as they could be. Second, the 201 form audit process seems to span beyond the intent of ensuring adequate internal control of disbursements related to payroll. Prior to Payroll Control auditing the 201 forms they have already been reviewed by both the initiating department, Central Payroll in the Finance and Administration Department, and the Human Resource Department. Since the Payroll Control unit's audit of personnel action forms *does not result in a direct financial disbursement* to an employee and mainly consists of *re-verifying* that funds exist for open positions, this function could be considered duplicative or nonessential.

Track 201 form error rates for six-months and migrate toward eliminating the process of auditing 201 forms altogether.

FINDING/RECOMMENDATION

During FY 1996-1997, the City Controller's Office engaged an external consultant to conduct a performance review of the Financial Disbursement Division, which included Payroll Control. It was recommended that one payroll clerk's position be eliminated at the conclusion of the review. One of the objectives of this "Contract Certification and Payroll Control Process Review" was to determine if there is a staffing need for the payroll clerk's position that was eliminated during the previous review. Our review of the Payroll Control indicates that the unit can operate efficiently with existing staffing levels by implementing **Recommendations 2-1** through **2-3** contained in Chapter 2 of this report.

Maintain current Payroll Control staffing level by implementing Recommendations 2-1 through 2-3.

FINDING/RECOMMENDATION

The Controller's Office may be performing more payroll control functions than the Charter Code of Ordinances requires. The Charter Code of Ordinances requires only that after payrolls have been checked and certified by the commission, they should be delivered immediately to the City Controller. The Charter Code of Ordinances does not require that the Controller perform an internal control audit of central payroll. The review team conducted a benchmark survey of the 10 largest cities in the nation and

7 cities responded. Only one (Philadelphia) of the seven cities that responded had a payroll control function similar to that of the City of Houston. The remaining cities either relied on individual departments to ensure the accuracy of payroll processing or handled the internal control function through the internal audit function.

Revise the Controller's Office internal audit plan to include targeting the accuracy of payroll input at the department level and central payroll processing accuracy levels. Depending on dollar volume risk identified, transfer appropriate payroll control functions to internal audit.

Chapter 1

CONTRACT CERTIFICATION

This chapter of the report reviews the contract certification process, which is the responsibility of the Operations Division of the Office of the City Controller (the Controller). The chapter has been divided into two sections:

- A. Operations
- B. Automation

The focus of this review was to streamline certification procedures and strengthen related internal controls. The three primary objectives for evaluating the process were to:

- Assess the efficiency and effectiveness of RCA certification procedures, related internal controls, processes, staffing, and technological capabilities within the Operations Division.
- Determine the necessary procedures and controls to achieve a realistic turnaround time (number of days) for RCA certifications.
- Evaluate existing databases for potential improvement.

COMMENDATION

The Funds Certification staff has managed a high level of organizational change effectively. Over the past three years, a new Controller has been elected, a new financial accounting system has been installed, and RCA volume has remained at a high level. Despite these challenges, departmental personnel said that the Funds Certification staff have remained responsive to their needs during this period. Also, the review team observed the positive team spirit and leadership displayed by the Funds Certification staff while they assisted departmental personnel in using the new financial accounting system.

BACKGROUND

In accordance with the City Charter (Charter), City Council (Council) must pass ordinances to approve all contracts, agreements, and expenditures that exceed \$5,000. The Charter also requires the Controller to certify that funds are available prior to incurring any obligation. Requests for expenditure of funds originate in City departments. The process that formally documents these requests is known as Request for Council Action (RCA). In connection with this process, the Council relies upon the Controller to maintain a system to certify that funds are available prior to incurring any obligation.

The required system must have strong internal controls that include well-documented procedures, training of employees, proper review and approval at each stage, and methods that allow for timely processing and monitoring of transactions. At the same time, it must prevent and detect errors in a timely manner and ensure that funds are used as intended. Finally, optimizing the use of technology to streamline, expedite, and monitor the execution of all transactions is imperative. The RCA system in place is manual and lacks a central database for tracking document status and identifying bottlenecks.

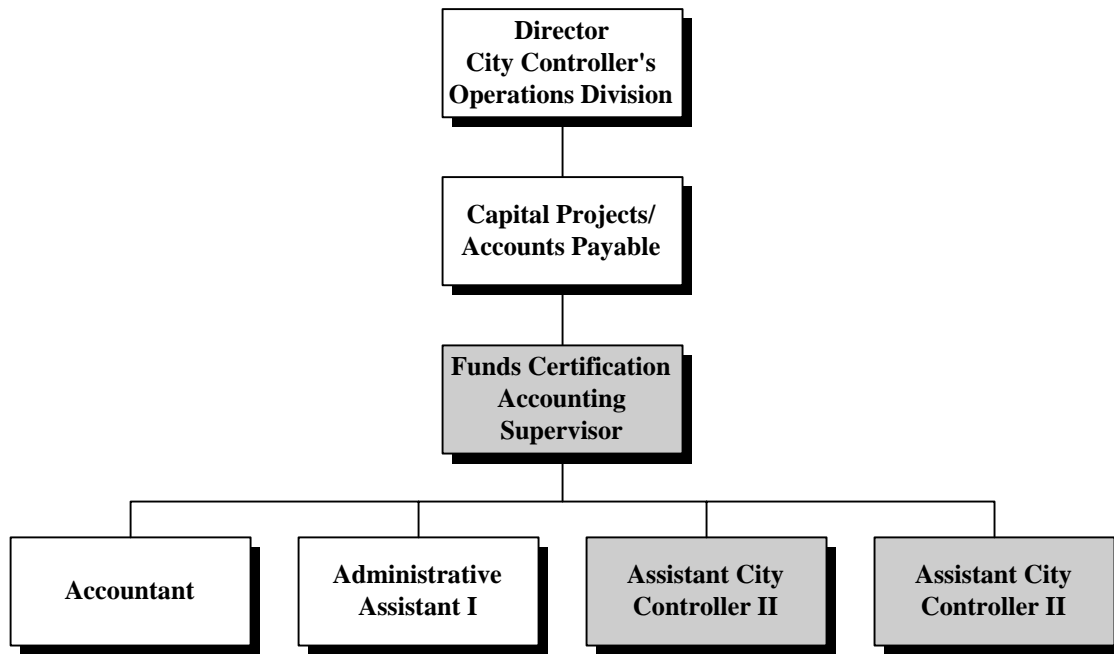
The size of the City’s operating budget mandates a sound system. The City’s operating budget for the past five fiscal years (FY 1996-2000) has been in excess of \$2 billion annually.

The Operations Division of the Controller, Capital Projects/Accounts Payable unit, has primary responsibility for the certification process. This unit is also responsible for financial disbursements of capital projects, grants, and operating budget expenditures. Payments for these expenditure categories were decentralized in prior fiscal years. In FY 1999, the organization was restructured to centralize the payments. Realignment satisfied a prior audit recommendation.

For the certification process, the Funds Certification Accounting Supervisor reports to the Capital Projects/Accounts Payable unit and is responsible for the direct day-to-day supervision of the required procedures. The Funds Certification Accounting Supervisor is supported by two Assistant City Controller II positions, generally referred to as Certificate Processors. Two other reports, the Accountant and the Administrative Assistant I, have no involvement in the certification process. Both perform post-certification procedures.

Exhibit 1-1 illustrates the organizational structure of the Operations Division, Capital Projects/Accounts Payable unit for the certification process. The Funds Certification Accounting Supervisor and Certificate Processors have other responsibilities in addition to the application of certification procedures.

**Exhibit 1-1
Functional Organizational Structure for Funds Certification Process**



Source: Controller Operations Division.

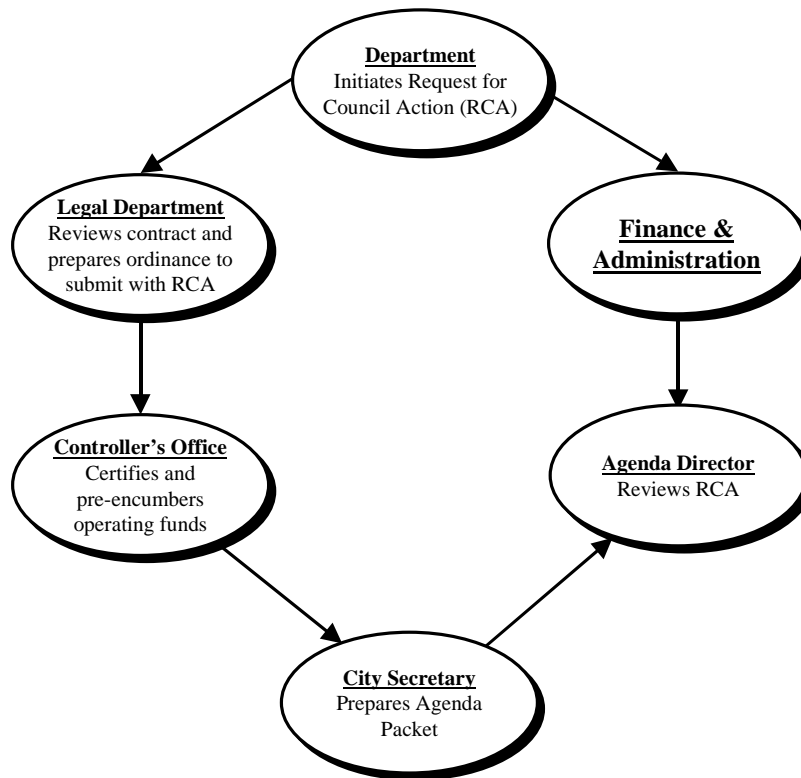
Note: The shaded areas represent positions responsible for the certification process.

A. OPERATIONS

City departments initiate the certification process by preparing the Request for Council Action (RCA) form. The purpose of the form is to summarize the subject matter to be approved by Council. Four types of RCAs require ordinances: operating, bond fund, grant application and acceptance, and grant awards. All four types of RCAs are processed similarly.

Upon completion of the RCA, the issuing department prepares the requisition on-line in the Advantage Financial Management System (FMS). The requisition screen in FMS is copied and attached to the RCA. The unexecuted contract, agreement, and bid documents are also attached to the RCA. The RCA is then distributed on two separate tracks. **Exhibit 1-2** illustrates the process flow for RCA documents. The original copy without the requisition and other supporting documentation is sent to the Finance and Administration Department for budget verification and then on to the Agenda Director. A copy of the RCA with the requisition and supporting documentation is submitted to the Legal Department (Legal). Legal negotiates the terms of the final contract and prepares the ordinance and the Ordinance Summary Sheet. The RCA, requisition, final contract, and ordinance are submitted to the Controller for certification.

**Exhibit 1-2
RCA Process Document Flow**



Source: Controller Operations Division.

After receipt of the RCA and supporting documentation from Legal, the Controller enters the RCA data into the tracking log. The Certificate Processors then review the RCA form for the signature of the Department Director submitting the request.

Next, the processors make a copy of the Ordinance Summary Sheet (Ordinance). An ink imprint with blocks showing fund, department, project, budget organization, appropriation code, object ordinance number, amount, and contract number is placed on the copy. An imprint is made for each vendor if more than one vendor is related to the RCA. The accounting information is completed for each block. This copy is maintained for Controller records because the original is forwarded to the City Secretary after the Controller signs it. The original is not defaced with the ink imprint.

If the RCA is being funded from bond issues, the Capital Improvement Plan (CIP) number on the Ordinance is compared to the RCA.

The dollar amounts on the Ordinance for the goods and services to be provided are agreed to those on the RCA. If multiple contracts are included on one ordinance, the summation of the individual amounts for each contract should agree to the total ordinance amount. The funding source is also verified as appropriate.

For grant applications, a reference number is assigned for tracking purposes after the dollar amounts have been matched between the RCA and the Ordinance.

When the RCA contract period extends beyond the current fiscal year, the initial encumbrance amount must be verified. The initial encumbrance amount is the total funds to be expended in the current fiscal year.

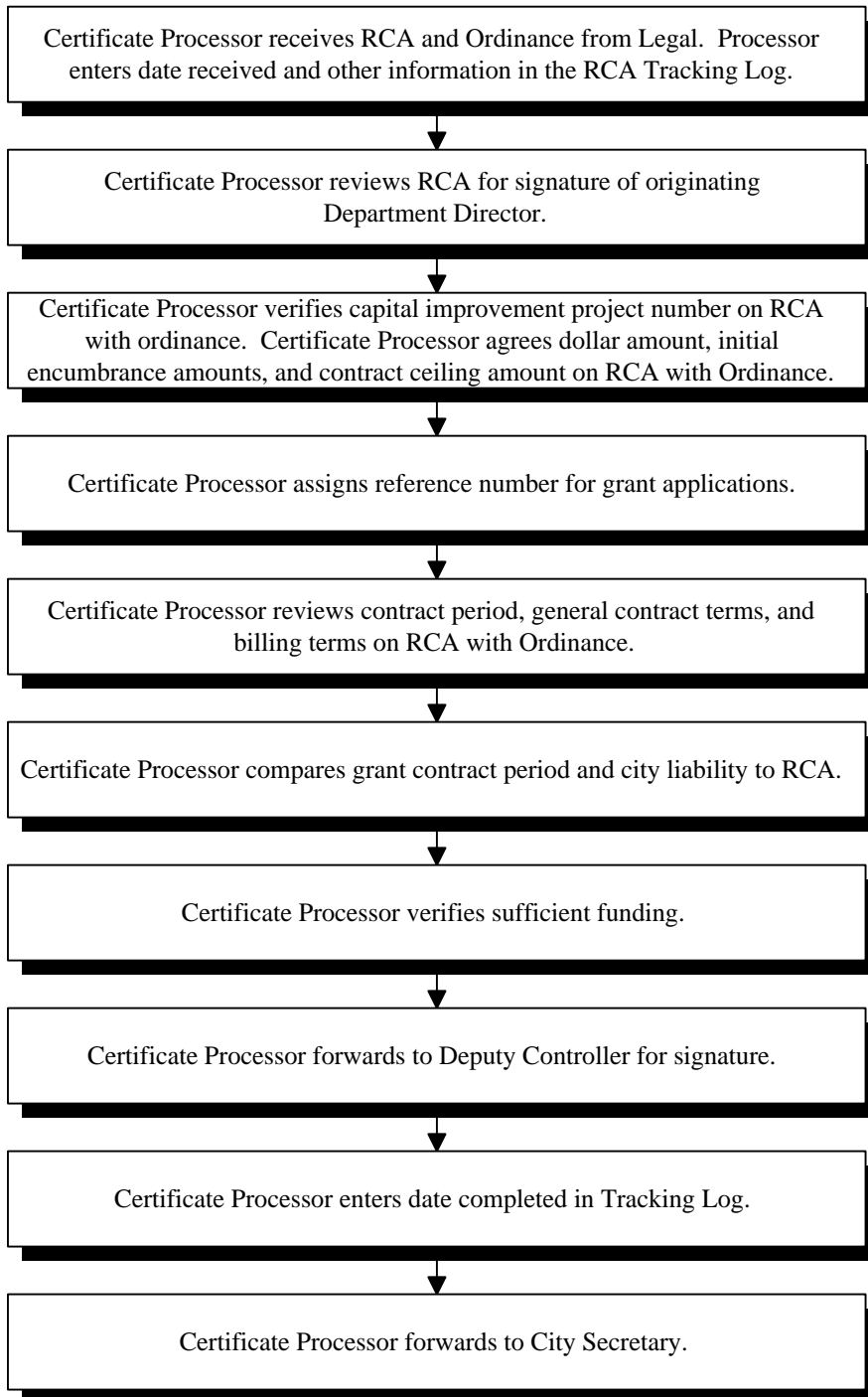
After the encumbrance review, the processors verify the period of the contract to the RCA. They also review for consistency of the general contract terms between the contract and the RCA. Another review is performed to determine the clarity of billing rates in terms of hours or flat rate.

The Controller certifies sufficient funding by confirming that the copy of the requisition from the department is attached. Sufficient funds are verified when the processors issue electronic approvals to the requisition. For bond issue projects, the processors review the Bond Status Report to verify funding.

The processors initial the Ordinance after the electronic approvals have been applied. The documents are then forwarded to the Accounting Supervisor, for review and approval. The documents are returned to the processors. They enter the date the RCA was submitted to the Controller in the tracking log.

The Ordinance and RCA copy is sent to the Director of Operations for review and then on to the Deputy Controller for signature. After the Deputy Controller signs it, the RCA package is returned to the Certificate Processors to log the date the Ordinance and RCA were sent to the City Secretary. **Exhibit 1-3** presents a recap of detailed procedures for each RCA.

**Exhibit 1-3
Recap of Detailed RCA Procedures**



Source: Controller Policy and Procedure Manual.

FINDING

Article II, Section 19a of the City of Houston Charter Code of Ordinances states that:

- *“No contract, agreement or other obligation involving the expenditure of money in excess of five thousand dollars shall be ordered, authorized, entered into, or executed by any officer of the city unless same be, by authority of ordinance, resolution or motion, nor shall any ordinance, for the appropriation of money, or any ordinance, resolution or motion for the making of any contract, agreement or other obligation requiring the expenditure of money, be passed by the council unless the controller first certify to the council, that the money required for such contract agreement, obligation or expenditure is in the treasury, and not appropriated for any other purpose or that the funds will be received into the treasury and be available before the maturity of said obligation, and that the said funds anticipated have not been already appropriated for any other purpose, which certificate shall be filed and immediately recorded.”*

Based on Charter requirements, the Controller’s primary responsibilities related to Funds Certification are to certify that either (1) funds are available to meet expenditure obligations or (2) funds will be available before the maturity of the obligation.

Based on the review team’s analysis of Fund Certification procedures and interviews with staff, current certification procedures followed by staff exceed the Charter requirements. For example, Funds Certification staff members perform a review for the provision granting the City the right to audit contractor's books and records and for the monetary unit of payment, such as hourly or flat rate. These reviews are performed to provide assistance to the Legal department. Based on interviews with the staff, standard language is not used in the contracts, making it difficult to find these provisions.

Recommendation 1-1:

Discontinue the review for contract provisions that grant the City the right to audit contractor’s books and records and for review of monetary unit of payment such as hourly or flat rate.

Funds certification staff should discontinue the review of legal terms and conditions pertaining to audit of contractor records and monetary unit of payments. Prior to discontinuing these reviews, the Controller’s Office should draft a memorandum to the Legal department detailing a phased out approach. The plan should itemize in detail the items that are reviewed so that the Legal department can include them as standard language in the contract. The items should be negotiated in advance along with other contract terms and conditions.

The plan should also include a goal for a minimal error rate agreed to by the Legal department. Once this goal is achieved, the review can be discontinued.

IMPLEMENTATION STRATEGIES AND TIMELINES

1. The Director of Operations informs the Legal Department by memorandum that the Controller’s Office plans to discontinue review for right to audit contractor’s records and monetary unit of payment. The Director of Operations also requests that Legal implement a proactive approach to contract negotiations to ensure that all Controller issues are included in the contract. October 1999

2. The Director of Operations directs the Funds Certification Accounting Supervisor via memorandum to end the review process for contractual terms and conditions. October 1999

FISCAL IMPACT

This recommendation can be implemented with existing resources.

FINDING

Funds Certification staff members perform redundant procedures including:

- Photocopying the ordinance summary sheet and placing an ink imprint block that contains information that is already included on both the RCA and requisition document.

- Affixing multiple approval signatures to the RCA. Three persons within the Controller’s Office sign the Ordinance: (1) the Certificate Processor, (2) the Accounting Supervisor, and (3) the Deputy Controller. A fourth person, the Director of Operations, reviews the RCA. The average number of days required for the Deputy Controller to sign and forward RCAs to the City Secretary is shown in **Exhibit 1-4**.

**Exhibit 1-4
Average Number of Days
For Deputy Controller’s Signature**

CALENDAR YEAR	TOTAL	AVERAGE NUMBER OF DAYS TO PROCESS					Avg. no. of days
		0-5 days	6-10 days	11-20 days	21-30 days	Over 30 days	
1997	---	---	---	---	---	---	---
1998	1,078	748	200	102	10	18	6
1999	356	316	32	6	--	2	5

Source: Controller RCA Tracking Log.

Note: Calculations for 1999 are based on tracking log data for January 1999 through June 1999 only.

Exhibit 1-5 shows a copy of the FMS Requisition Form, which contains RCA accounting information.

Exhibit 1-5
FMS Requisition Form

FUNCTION: DOCID: RX 60 PR10CTF0011 01/26/99 02:25:22 PM
 STATUS: PEND5 BATID: ORG:
 REQUISITION INPUT FORM
 DATE: 01 26 99 ACCT PRD: BFY: 99 ACT: E TRACK CO: DEL DATE: 03 01 99
 VENDOR CODE: 243974 0 RESP AGENCY/ORG: 10 1362 COMMENTS:
 NAME: DUPONT FLOORING SYSTEMS SHIP/BILL TO: 333 I10 TYPE:
 ADDRESS: 5849 WESTVIEW BLDG/ROOM: TAX:
 HOUSTON TX 77055 RESP PERSON: LISA CHANG
 CONTACT: MIKE FARMER LINK: Y REQ PHONE: 713-308-1749
 PHONE: 713 680 3111 BS ACCT: WHSE: ITEM TOTAL: 16,000.00
 DISC CODE: FREIGHT IND: FRGHT I/D: FRGHT TOTAL:
 TOTAL AMT: TOT AMT I/D: CALC TOT AMT:
 TOTAL QTY: TOT QTY I/D: CALC TOT QTY:
 LN FUND AGY ORG/SUB APPR UNIT ACTV FUNC OBJ/SUB JOB # RCAT TOTAL I/D
 01 100 10 1362 2000 2200 16,000.00 I/D

CONTROLLER'S OFFICE
 O & C DIVISION
 Electronic Approval
 Date: 1/28/99

H--*S405-READY FOR APPROVAL 5

Requested By: Jammy Blackenship Date: _____
 Prepared By: Lisa Chang Date: 1/26/99
 Approved By: _____ Date: _____
 I-4 Approved: _____ Date: _____

Source: Fund Certification Unit.

Exhibit 1-6 shows a copy of the Ordinance Summary Sheet Ink Imprints, which duplicates the accounting information contained on the requisition form.

Exhibit 1-6
Ordinance Summary Sheet/Ink Imprints

FORM 159.1M
(Award/Supplemental)

Controller's Office

To the Honorable Mayor and City Council of the City of Houston:

I hereby certify, with respect to the money required for the contract, agreement, obligation or expenditure contemplated by the ordinance set out below that:

- Funds have been encumbered out of funds previously appropriated for such purpose.
- Funds have been certified and designated to be appropriated by separate ordinance to be approved prior to the approval of the ordinance set out below.
- Funds will be available out of current or general revenue prior to the maturity of any such obligation.
- No pecuniary obligation is to be incurred as a result of approving the ordinance set out below.
- The money required for the expenditure or expenditures specified below is in the treasury, in the fund or funds specified below, and is not appropriated for any other purposes.
- A certificate with respect to the money required for the expenditure or expenditures specified below is attached hereto and incorporated herein by this reference.
- Other - Grant Funds Available

2 yr. contract
2 (1 yr. renewal)
PAL

Date: _____, 19____ City Controller of the City of Houston

FUND REF: ~~100-10-3600~~ AMOUNT: \$2,000.00 ENCUMB. NO.: ~~800750~~

City of Houston Ordinance No. _____

AN ORDINANCE AWARING CONTRACTS TO DUPONT FLOORING SYSTEMS INC., TN FLOORING COMPANY, INC. AND M.E.K. INTERIORS & FLOORS, INC. FOR CARPET, TILE, MATERIALS AND INSTALLATION SERVICES FOR THE HOUSTON POLICE DEPARTMENT; PROVIDING A MAXIMUM CONTRACT AMOUNT; MAKING VARIOUS FINDINGS AND PROVISIONS RELATING TO THE SUBJECT; AND DECLARING AN EMERGENCY.

M.E.K. INTERIORS & FLOOR

FUND	100
DEPT-DIV	10
PROJECT	N/A
EXP-BUDGT ORG	1362
APPROP CODE	3000
OBJECT	3600
ORDINANCE	
AMOUNT	31752.00

PK 60 - PROJECT 0009
20,000.00 (initial Enc.)

DUPONT FLOORING SYS

FUND	100
DEPT-DIV	10
PROJECT	N/A
EXP-BUDGT ORG	1362
APPROP CODE	3000
OBJECT	3600
ORDINANCE	
AMOUNT	204,320.00 (initial 1000.00)
CONTRACT	

PK 60 - PROJECT 0011 - 16,000.00

1 - TN FLOORING CO.

FUND	100
DEPT-DIV	10
PROJECT	N/A
EXP-BUDGT ORG	1362
APPROP CODE	3000
OBJECT	3600
ORDINANCE	
AMOUNT	12,517.00
CONTRACT	

PK 60 - PROJECT 0012 - 4000.00 (initial Enc.)

Source: Fund Certification Unit.

Recommendation 1-2:

Eliminate the ink imprint information and the requirement for the signature of the Deputy Controller.

Eliminate the ink imprint of accounting information. The same accounting information is included on the requisition form, which can be used for the same purpose as the ink imprint information.

Eliminate the signature of the Deputy Controller. The other three staff members within the Controller’s Office are closer to the transaction with sufficient information, experience, and judgment to ensure proper execution.

IMPLEMENTATION STRATEGIES AND TIMELINES

- | | |
|--|---------------|
| 1. The Director of Operations directs the Funds Certification Accounting Supervisor via a memorandum to stop placing the ink imprint accounting information on the Ordinance and use the requisition for the same purpose. | October 1999 |
| 2. The Deputy Controller trains the Director of Operations on RCA approvals. The Controller approves elimination of the Deputy Controller’s signature. | December 1999 |

FISCAL IMPACT

This recommendation can be implemented with existing resources.

FINDING

The Funds Certification staff issues electronic approval to requisitions received from departments. Since electronic approval has not been granted to departments at the time requisitions are prepared, FMS does not pre-encumber or obligate the requisitioned amount. Due to the timing difference of receipt and processing by Funds Certification staff, other transactions that are not subject to the RCA process may be executed, creating insufficient funds problems for the RCA. Through interviews with Fund Certification staff and departmental personnel, MJLM learned that this is a frequent occurrence.

Recommendation 1-3:

Assign departments electronic approval authority.

Departments should be allowed to make electronic approvals. FMS has the system controls to pre-encumber funds when requisitioned at the department level. Established controls in the system will prevent departments from overspending. As an added measure, departments will be precluded from reversing approvals. This will also prevent funds from these requisitions being used by requisitions that are not subject to the RCA process. Insufficient funds due to timing differences in processing RCA requisitions will be eliminated.

IMPLEMENTATION STRATEGIES AND TIMELINES

- 1. The Controller issues a memorandum to the Departments and ISD granting permission for issuing electronic approvals. October 1999
- 2. ISD establishes privileges for departments to apply electronic approvals. November 1999

FISCAL IMPACT

This recommendation can be implemented with existing resources.

FINDING

The current threshold of \$5,000 is too low and results in a high volume of transactions that have minimal dollar risk in relation to the total dollar value of the RCA and City budgets. Based on an analysis of Funds Certification tracking log data, the dollar value of transactions under \$25,000 represents less than 1 percent of the total dollars of RCAs processed for FY 1997-1999. At the same time, this category represents approximately 20 percent of the transaction volume of RCAs processed for the same period. Transactions in excess of \$1 million represent 87 percent of the total dollars and less than 25 percent of the total volume. However, regardless of the dollar volume, the same approval procedures are applied to all transactions. This practice requires a significant amount of administrative time to complete relatively low-dollar transactions. Further, in accordance with the standard annual budget process, after the Controller certifies that funds are available for all appropriations, the Council adopts an Ordinance appropriating funds to support the operations of City government. In effect, the RCA process represents a second budget approval by the Controller and Council. **Exhibit 1-7** presents a percentage analysis of stratified dollar categories to total dollars for all RCAs for FY 1997-1999.

**Exhibit 1-7
Request for Council Actions
Transactions by Dollar Stratification
FY 1997-1999**

Variable	\$0 - \$24,999	\$25,000 - \$49,000	\$50,000 - \$99,000	\$100,000 - \$999,000	\$1 million or over
FY 1997					
Number of Transactions	249	101	102	452	279
% of Total Transactions	21%	9%	9%	38%	23%
% of Total \$	0.1%	0.3%	0.6%	15%	84%
FY 1998					
Number of Transactions	225	109	144	427	303
% of Total Transactions	19%	9%	12%	35%	25%
% of Total \$	0.1%	0.2%	0.7%	11%	88%
FY 1999					
Number of Transactions	244	116	160	453	306
% of Total Transactions	19%	9%	13%	35%	24%
% of Total \$	0.2%	0.2%	0.6%	9%	90%

*Note: FY 1999 is through May 1999.
Source: Controller RCA Tracking Log.*

Based on a benchmark survey of four large cities around the country, the City of Houston is unique in its requirement of a certification procedure. Of the cities surveyed, only Houston and Los Angeles had an elected Controller. **Exhibit 1-8** summarizes the survey responses.

Dallas used a threshold of \$15,000 for approval of contracts by Council and Atlanta used \$50,000. Chicago allowed the City Council Finance Committee to approve contracts. The threshold for the committee was \$5,000. Los Angeles did not report contract transactions to Council, but allowed departments to execute contracts.

**Exhibit 1-8
Benchmark Survey for Houston and Peer Cities
Contract Certification Process**

Variable	Houston	Atlanta	Chicago	Dallas	Los Angeles
FY 1999 Budget	\$2.2 Billion	\$406 Million	\$4 Billion	\$2.4 billion	\$4 Billion
Organization and Management					
Form of government	Mayoral	Mayoral	Mayoral	Council Manager	Mayoral
Elected Controller	Yes	No	No	No	Yes
Administrative Information Systems					
Management Information System Used	AFMS	Use internally developed software. Plan to convert to People Soft in Sept. 1999.	Use internally developed software. Plan to convert to Oracle Financial Management System (date not determined).	AFMS	Use internally developed software.
Electronic agenda system	No	No	No	Yes - developed in-house	No
Process					
Expenditure of funds require Controller approval and Council action	Yes	No—after the budget is approved, spending is allowed within budgetary limits. Any increases to original budget require Council action.	No—after the budget is approved, spending is allowed within budgetary limits. Any increases to original budget require Council action.	No—after the budget is approved, spending is allowed within budgetary limits. Any increases to original budget require Council action.	No—after the budget is approved, spending is allowed within budgetary limits. Any increases to original budget require Council action.

**Exhibit 1-8
Benchmark Survey for Houston and Peer Cities
Contract Certification Process (Continued)**

Variable	Houston	Atlanta	Chicago	Dallas	Los Angeles
Dollar threshold for Contract Approval	\$5,000	\$50,000 and greater. No certification by Controller required, only contract approval by Council.	\$10,000 and greater, contracts approved by a Finance Committee of Council. Contracts do not go to full Council body. Finance Committee meets monthly.	\$15,000 and greater, Controller and Budget Office verify funding. Organizationally, these offices both report to the Assistant City Manager-CFO.	None—City Council approval of contracts not required. Mayor appoints a Public Works Board that approves for Public Works Department. Internal Audit routinely reviews contracts.

Source: Benchmark Survey Conducted by the Review Team.

Recommendation 1-4:

Establish a higher dollar threshold for RCA transactions requiring Controller approval. Report transactions below threshold to Council for information purposes only.

Based on Funds Certification transactions for the last three fiscal years, a higher threshold of \$25,000 would eliminate an average of 20 percent of total transactions processed. (See **Exhibit 1-7.**) The transactions that are recommended for elimination have a low amount of risk in relation to the total dollar value of the RCAs and City budgets. Higher dollar transactions that carry more liability would receive a more careful review and would also be processed more expediently. The overall quality and timeliness of the process would be improved, placing more emphasis on the transactions with a greater monetary impact on the finances of the City.

Transactions under the threshold would be reported to Council for information purposes. Internal Audit would include as part of their annual audit plan a review transaction under the threshold for compliance with expenditure procedures.

IMPLEMENTATION STRATEGIES AND TIMELINE

- | | |
|--|---------------|
| 1. The Director of Operations prepares a statistical report to support increasing the threshold. | October 1999 |
| 2. The Director of Operations submits the report and recommendation for increasing the threshold to the City Controller. | October 1999 |
| 3. The City Controller reviews and approves the recommendation. | October 1999 |
| 4. The City Controller prepares a resolution requesting City Council to obtain voter approval for increased threshold. | November 1999 |
| 5. The voters approves the increased threshold. | November 1999 |

- | | |
|--|---------------|
| 6. The City Controller distributes a memorandum informing all departments of the new threshold. | December 1999 |
| 7. The City Secretary reports RCAs below the threshold to Council for information only on a monthly basis. | January 2000 |
| 8. The Director of Internal Audit includes a review of RCAs below threshold audit plan for the current year. | January 2000 |

FISCAL IMPACT

This recommendation can be implemented with existing resources.

FINDING

Both Certificate Processors perform maintenance and monitoring of contract activity in addition to certification procedures. The Funds Certification Accounting Supervisor estimates a 50 percent split between both functions. These split functions can be combined into one to facilitate continuous processing of RCAs.

Exhibit 1-9 shows major responsibilities for capital projects and Funds Certification positions.

**Exhibit 1-9
Staff Positions Responsible for Performing RCA/related Functions**

Staff	Major Position Responsibilities
<i>Accounting Supervisor</i>	
<i>RCA Certification Procedures</i>	<ul style="list-style-type: none"> • Plans and coordinates distribution of RCAs to staff for processing. • Reviews and approves RCAs processed by staff for accuracy and funding certification. • Serves as a liaison between Departments and Controller for RCA Processing. • Supervises, trains and evaluates staff performance.
<i>Capital Projects and Grants Procedures</i>	<ul style="list-style-type: none"> • Plans and coordinates maintenance of contract status and history activity in FMS. • Prepares budgets for approved ordinances. • Plans and coordinates processing of supplementary allocation letters.
<i>Certificate Processors</i> <i>Total Staff = 2</i>	

**Exhibit 1-9
Staff Positions Responsible for Performing RCA/related Functions (Continued)**

<i>RCA Certification Procedures</i>	<ul style="list-style-type: none"> • Maintain log of incoming and outgoing RCAs. • Review RCA documentation for proper support, signatures, and agreement of information between documents. • Review RCAs for certification of funding. • Assist departments with completing and correcting RCAs.
<i>Capital Projects and Grant Procedures</i>	<ul style="list-style-type: none"> • Perform procedures for entering budget data for approved RCAs in the AFMS. • Maintain price agreement tables for status and history of contract activity. • Process supplemental allocation letters; enter original and subsequent appropriations, and maintain spending activity.

Source: Controller Operations Division, Capital Projects and Grants Section.

Recommendation 1-5:

Reassign all funds certification processing to one accounting position and maintenance and monitoring of contract responsibilities to the other accounting position.

All processing responsibilities associated with maintenance and monitoring of contract activity and history should be reassigned to one position, allowing the other position to work fulltime on RCA processing. Job duties for the Accountant and Administrative Assistant should be evaluated to determine if these duties could be integrated into their job responsibilities.

IMPLEMENTATION STRATEGIES AND TIMELINES

- | | |
|---|---------------|
| 1. The Director of Operations evaluates the job responsibilities of the Funds Certification accounting positions. | October 1999 |
| 2. The Director of Operations develops job descriptions based on the revised responsibilities. | November 1999 |
| 3. The Director of Operations reassigns responsibilities for the Funds Certification accountants. | December 1999 |

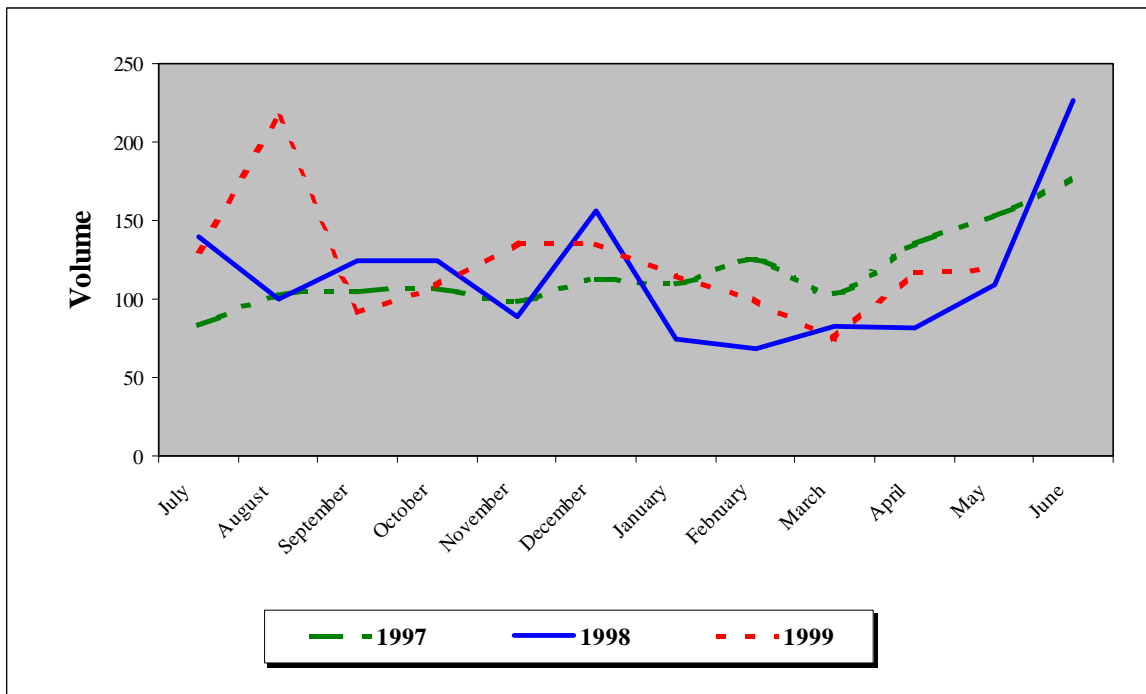
FISCAL IMPACT

Funds Certification accountants should maintain their same salaries. Therefore, this recommendation should have no financial impact on the Controller’s Office budget.

FINDING

Historically, City departments have not effectively planned the use of their budget resources during the fiscal year or in instances where large projects overlap fiscal years. Based on an analysis of Funds Certification tracking log data, monthly volume peaks commonly occur in the last two months of the fiscal year. This pattern shows that departments attempt to expend any unobligated funds prior to fiscal year-end close out. Since the Council adopts the budget before the start of the fiscal year, proper planning would entail acquisition of goods and services in the first quarter for use throughout the fiscal year. The same analysis shows a significant increase in transaction volume (in the middle of the fiscal year) in an instance where all funds were not expended on a large contract and a high number of RCAs were processed in order to expend remaining funds. **Exhibit 1-10** displays an analysis of monthly volume for FY 1997- 1999.

**Exhibit 1-10
Request for Council Actions - Monthly Volume
FY 1997-1999**



Source: Controller RCA Tracking Log.

An analysis was also performed on the average number of days required to process RCAs in the Controller’s Office for the same period. RCAs processed within 1 and 2 days for the three-year period totaled 470. This indicates that a large volume of RCAs required emergency processing, since the lowest average turnaround time was six days in any of the three years. Emergency requests are not formally documented, but Funds Certification staff said that emergencies impose an undue burden and prevent timely processing of RCAs. **Exhibit 1-11** indicates the average number of days required to process RCAs for FY 1997-99.

**Exhibit 1-11
Request for Council Actions
Calendar Years 1997 - 1999**

CALENDAR YEAR	TOTAL	AVERAGE NUMBER OF DAYS TO PROCESS						
		1-2 days	3-5 days	6-10 days	11-20 days	21-30 days	Over 30 days	Avg. no. of days
1997	1,488	319	518	462	144	39	6	6
1998	1,263	89	197	267	434	132	144	17
1999	403	62	65	107	132	33	4	10

Source: Controller RCA Tracking Log.

Note: Calculations for 1999 are based on tracking log data for January 1999 through June 1999 only.

Average processing time increased in calendar year 1998 because review procedures were applied more strictly. In calendar year 1999, processing time declined because two additional employees were hired to assist in the review of RCA transactions.

Memoranda about targeted turnaround time frames for completing Funds Certifications are not distributed to Funds Certification staff. For example, the Funds Certification Accounting Supervisor and the two Certificate Processors were unaware of a memorandum from the Council Agenda Office dated April 1999, which established a target turnaround time of five working days for the completion of Funds Certifications. In another instance, a memorandum dated March 29, 1999, from the Deputy Controller describing the procedure for communicating incomplete RCA forms was distributed to departments; however, the Funds Certification Accounting Supervisor and the Certificate Processors were not aware of this memorandum.

Recommendation 1-6:

Distribute a memorandum to Finance and Administration describing the increased volume of transactions at year-end and the burden it imposes. Establish deadlines for processing RCAs for council agenda.

The Finance and Administration Division should require that departments file priority-spending plans at the beginning of each fiscal year, prior to submission of any requisitions. These plans should detail quarterly spending. This action would encourage departments to be proactive and execute requisitions more evenly. Theoretically, funds would be expended at the beginning of the year in order to have use of the goods and services for the entire year. Proactive planning would also minimize the need for emergency requests.

Funds Certification staff having a direct role in the RCA process should be provided with all external communication concerning the RCA process prior to distribution.

The Controller should establish deadlines for processing RCAs and distribute a memorandum advising departments of the new policy.

IMPLEMENTATION STRATEGIES AND TIMELINES

- | | |
|---|------------------|
| 1. The Director of Operations meets with staff to discuss establishing realistic deadlines. | October 1999 |
| 2. The Controller distributes a memorandum notifying departments of deadlines. | October 1999 |
| 3. The Controller distributes a memorandum to Finance and Administration describing year-end burden and suggesting spending plan requirements. | February 2000 |
| 4. The Director of Finance and Administration conducts meeting with staff to consider and prepare plan to implement spending plan requirements. | March-April 2000 |
| 5. The Council approves the new Finance and Administration requirement. | April 2000 |
| 6. The Departments file spending plans. | May 2000 |
| 7. The Controller distributes a memorandum notifying departments of deadlines. | May 2000 |

FISCAL IMPACT

This recommendation can be implemented with existing resources.

FINDING

Both individuals who occupy the two Assistant Controller I positions have been in the Funds Certification area for less than six months. Based on interviews with the Funds Certification Accounting Supervisor, on-the-job training for staff has been informal. Job descriptions have not been developed for the two positions. As a result, some required procedures are not performed completely. For instance, many of the data fields on the tracking log maintained by the Controller are incomplete. Different codes are used for some of the same data elements on the log.

In reviewing the actual daily procedures, the review team noted that some were not documented consistently or completely. **Exhibit 1-12** shows a summary of procedures that are outdated, no longer performed, or not documented.

**Exhibit 1-12
Summary of Outdated, Unperformed, and Undocumented Procedures**

Procedure	Current Documented Process Outdated	Documented in Procedure as manual but not performed	Procedure is performed but not documented	Explanation
Create Ordinance Summary Sheet		●		Summary sheet is prepared and submitted by the Legal Dept.
Prepare Audit Exception Sheet		●		Controllers use the telephone to expedite communication about exceptions. No record of exceptions is maintained.
Controller office prepares requisition with –PE reference	●			Requisition is prepared by the department. Reference in new system is RX.
Appropriation document reference is shown as CA.	●			New reference is AP.
RCA is submitted to Controller from City Secretary for grant applications.	●			RCA submitted to the Controller from Legal department.
Controller photocopies ordinance summary sheet, places ink imprint accounting information for each vendor, and fills in accounting information.			●	These steps are not described in the current procedures.
RCA package is signed by: 1. Certificate Processors 2. Accounting Supervisor 3. Director of Operations 4. Deputy Controller			●	These signatures are not described in the current procedures.

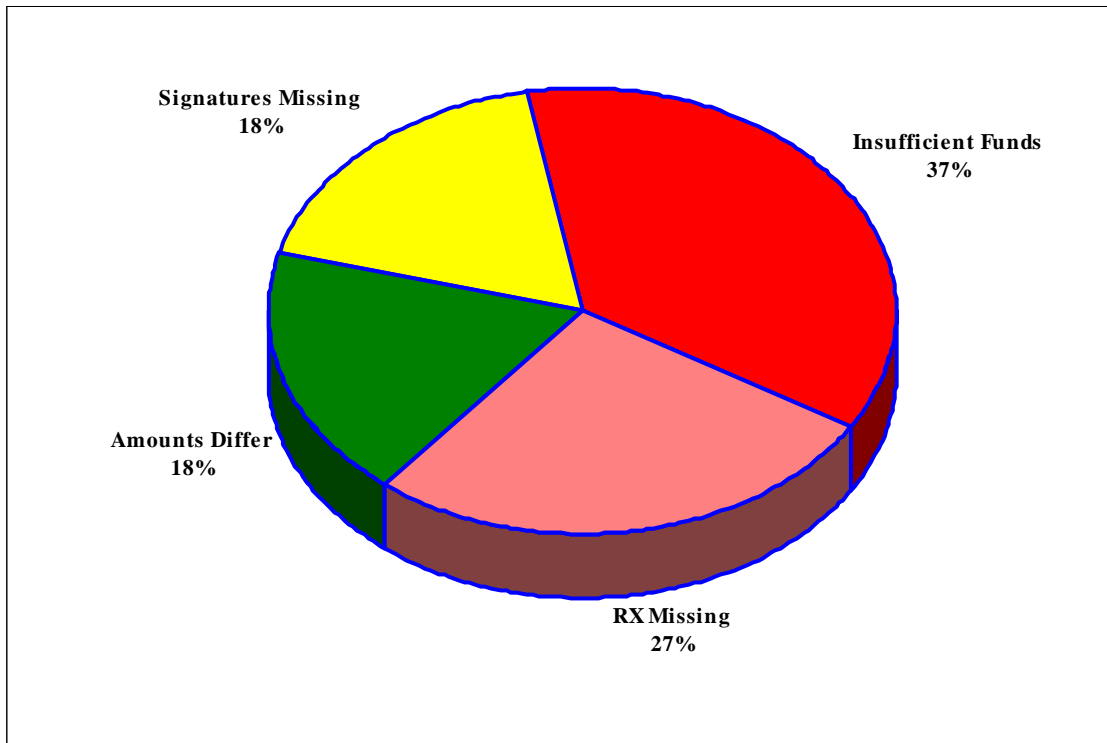
Source: Controller Policy and Procedure Manual and Observation of Performance of Duties.

Policies and procedures provide standards, guidelines, and a uniform manner for processing transactions. If accurately documented, they can be a tremendous aid for training employees. However, to be an effective component of internal control, policies and procedures must be current, reflective of how the organization functions in the present.

Similarly, based on interviews with personnel from City departments involved with the RCA process, no formal training has been provided to assist them in correctly processing RCAs for the Controller. According to Funds Certification staff, the Controller receives many RCAs with three common errors: (1) the RCA is not signed, (2) the requisition document is missing, (3) insufficient funds are available to approve the RCA. Funds Certification staff said that they receive frequent calls from department personnel requesting assistance on how to enter requisition information into the FMS.

Since the Controller does not document the type of errors found on RCAs that require them to be returned, the review team asked the Funds Certification staff to document error types for the period between May 24, 1999 and June 4, 1999. The types of errors noted were similar to those indicated during interviews. **Exhibit 1-13** shows the percentage of errors by category noted during the observation period.

Exhibit 1-13
Request for Council Actions
Analysis of Processing Errors
(Observation Period May 24, 1999 through June 4, 1999)



Source: Controller Operations Division.

Recommendation 1-7:

Update the policy and procedure manual to include all steps involved in the Funds Certification process and conduct training programs for internal staff and departments involved in the RCA process.

Training is a key strategy in developing a more efficient organization and improving processes. Formal training manuals that include a description of city government, organizational structure of city government, chartered responsibilities, flow chart of the entire RCA process, narrative explanation of detail procedures of the flow charts, and sample documentation should be provided to the staff. Representatives from each department should be included as members of a project team established to develop a training program and manual.

In addition to the areas described above, departmental training should focus on the major problem areas. Users should be trained specifically on how to complete the RCA form, the importance of completing all the information on the form, how the information is used, and how to enter requisition information.

Prior to RCA process training, the staff should be trained in fundamentals of internal control. The training should define internal control, describe a system of internal control, identify elements of a system of

internal control, and indicate the persons responsible for adherence to the internal control system. With this foundation, staff persons will be able to clearly understand their role in the RCA process.

IMPLEMENTATION STRATEGIES AND TIMELINES

- | | |
|---|---------------|
| 1. The Director of Operations appoints a Project Team within the Operations Division for the purpose of updating all policies and procedures and preparing training programs and manuals. | October 1999 |
| 2. The Project Team meets, selects a chairperson, and establishes goals and objectives. | October 1999 |
| 3. The Project Team prepares a written plan assigning each member of the team with responsibility for a section and establishes timelines for completion. | November 1999 |
| 4. The Project Team provides bi-weekly status reports to the Director of Operations. | December 1999 |
| 5. The Project Team completes the draft of policies and procedures manuals and training programs. | January 2000 |
| 6. The Director of Operations reviews and approves draft and forwards it to the Controller for approval. | February 2000 |
| 7. The Controller reviews and approves the procedures manual. | March 2000 |
| 8. The Controller sends out a memorandum indicating the effective date for new policies and procedures. The memorandum includes a training program schedule for the new manual and the RCA process. A directive is issued requiring that all employees involved in the RCA process attend training. | April 2000 |
| 9. The Project Team conducts training sessions. | May 2000 |

FISCAL IMPACT

This recommendation can be accomplished by the existing Funds Certification staff and staff from City departments.

FINDING

The Capital Projects and Grants unit has no standards in place to establish performance targets or to measure efficiency and productivity. Basic operational data such as the number of RCAs processed, the average number of days required to complete the process, and the percentage of RCAs with errors are not prepared and periodically reported to upper management. In its present form, the RCA tracking log does not contain sufficient information to obtain essential operating statistics.

Recommendation 1-8:

Revise the existing RCA tracking log to capture data needed to facilitate accurate and timely management reports. Develop a performance measurement system that facilitates the collection and reporting of data that measures operational efficiency and productivity.

The performance measurement system should provide management with information to help track process improvement and meet organizational goals. The elements of the system should include goals, objectives and performance indicators such as output measures, outcome measures, and efficiency measures. A goal is the general end to be achieved by the organization. An objective is linked directly to the goal and targets specific action by a certain timeframe. Output measures count the units of production. Outcome measures assess the effectiveness of performance usually in ratios or percentages. Efficiency measures quantify productivity units.

A recommendation for each component of the performance measurement system follows:

Goal

To provide timely, accurate processing of RCAs.

Objective

To reduce the number of days required to process RCAs to five (5) days by June 30, 2000.

Output Measures

- Number of RCAs processed
- Number of RCAs by Department
- Number of RCAs by Category
- Number of errors by each department
- Number of RCAs processed by individual staff persons
- Number of errors by individual staff persons
- Dollar value of RCAs processed

Outcome Measures

- Percentage of RCAs processed within five days
- Percentage of RCAs with errors
- Percentage of errors by individual staff person

Efficiency Measures

- Average number of days to process RCAs
- Aging report for RCAs

The Funds Certification Accounting Supervisor should report the measures to the Director of Operations on a monthly basis. To assist with collecting the data needed to prepare the report, the current log should be revised as shown in **Exhibit 1-14**.

**Exhibit 1-14
Proposed RCA Tracking Log**

Current Log	Proposed Log	Comments
Document type	RCA category	Identifies RCA types with largest volume
Document ID	Document ID #	Assigns number by Dept
Date received	Date received	Identifies date received from department
Vendor name	Vendor name	Provides tracking information
Amount	Amount	Provides tracking & reporting information
Description	Date returned due to error	Determines resolution period
Ordinance number	Error types	Identifies most common errors
Date passed	Date returned with correction	Determines resolution period
Capital Improvement Plan #	Date to City Secretary	Determines total processing time
Date to Controller	Ordinance number	Provides tracking information
Date to City Secretary	Capital Improvement Plan #	Provides tracking information
FMS document acceptance date	Processor name	Determines staff productivity

Source: Review Team.

IMPLEMENTATION STRATEGIES AND TIMELINES

1. The Director of Operations adopts the recommended performance system. October 1999
2. The Director of Operations discusses the plan with staff persons to obtain feedback and buy-in. October 1999
3. The Director of Operations prepares the revised plan. November 1999
4. The Director of Operations distributes the plan and issues the directive to follow plan. December 1999
5. The Funds Certification Supervisor begins submission of monthly reports. January 2000

FISCAL IMPACT

This recommendation can be implemented with existing resources.

FINDING

Based on interviews with the staff, no follow up procedure is in place for RCAs that were not approved by Council. Duplicate RCAs can be submitted and subsequently obligate funds a second time because the original was never reversed. Pre-encumbrances are established in the system when the RCA is approved by the Controller. At this point funds are set aside and removed from the available balance. When approved by City Council, the contract is executed and the pre-encumbrance is reversed and encumbrances and expenditures are recorded. However, if the Council never takes action on the RCA, pre-encumbrances will commit funds indefinitely.

Recommendation 1-9:

Establish a policy to reverse all pre-encumbrances for RCAs outstanding for longer than 90 days.

The Controller should establish a policy to liquidate or reverse any pre-encumbrances for RCAs outstanding for more than 90 days. This policy would help minimize over-commitment of resources due to duplication as well as transactions that were never approved.

IMPLEMENTATION STRATEGIES AND TIMELINES

- | | |
|---|--------------|
| 1. The Director of Operations proposes a policy for reversing RCAs outstanding for more than 90 days. | October 1999 |
| 2. The Controller approves the policy. | October 1999 |

FISCAL IMPACT

This recommendation can be implemented with existing resources.

B. AUTOMATION

FINDING

The RCA Funds Certification process is manual, highly paper intensive, and disjointed. The RCA is a preprinted document without a numbering scheme. City departments initiate the RCA that is supported by bid proposals, contracts, agreements, grant applications, and ordinances. All of the supporting documentation is paper. These documents flow from the departments to Finance and Administration, Legal, Purchasing, the Controller, and the City Secretary via physical interoffice mail.

Each department uses its own RCA numbering scheme. Many departments also maintain tracking logs on personal computers. These satellite-tracking systems are not uniform nor are they linked via a network infrastructure. Once RCA forms are received by the Controller, Funds Certification staff also assign a unique identifying number for tracking purposes. Like the departments, the Controller also maintains a separate tracking log.

Based on discussions with the Information Services Division (ISD), the City Secretary currently uses an imaging system supported by Filenet/Watermark software. After ordinances are passed, all RCA documentation is scanned into an imaging database. The system has been in production since FY 1997. The documents are filed in a separate folder for each fiscal year. Within the fiscal year folder, the ordinances are filed by month and date sequence. Retrieval of an ordinance requires only the input of the ordinance number. The network infrastructure is in place for the Controller and other City departments to access and use the system, but a software license and scanner are needed to use the system.

The current imaging system is not true client-server technology. ISD indicated that developing a system in a client-server environment would be the best long-term solution.

Recommendation 1-10:

Automate the RCA process to improve efficiency. Provide departmental access to the imaging system in the short term. Develop a uniform client-server system as a permanent solution.

The Controller and other departments should obtain software licenses and scanners to begin utilization of the system. ISD should establish a secure file folder on the imaging system for the Funds Certification staff. All documents could be scanned to this folder by departments who have read-access privileges only. Another short-term measure, would be to use the internet for reporting RCAs that need additional information for processing. The Council agenda and minutes are already reported on the internet, which is accessible to all departments.

For the long term, a uniform system accessible to all departments should be developed in the client-server environment. The system design should include a unique transaction number, document tracking, and security privileges that limit access at different stages of the process. It should also provide capabilities for paperless processing, reporting of performance measures, and aging outstanding RCA's. The network technology would provide comprehensive services such as sharing of data files, electronic mail, printing, and other resources not provided by the imaging system.

IMPLEMENTATION STRATEGIES AND TIMELINES

- | | |
|--|-------------------------------|
| 1. The Controller and other department heads purchase software licenses and equipment for their areas. | November 1999 |
| 2. ISD provides training on how to use the scanning equipment to the Controller and department personnel. | December 1999 |
| 3. The Controller appoints a task force comprised of representatives from each department to design a paperless processing system. | January 2000 |
| 4. The task force meets with ISD to develop an electronic system for paperless processing. | February 2000 -
April 2000 |
| 5. ISD completes the design. | May 2000 |

FISCAL IMPACT

The processing of RCAs will improve tremendously once the client-server technology is installed. Costs will be incurred for acquisition of software licenses, scanning equipment, and ongoing maintenance of the equipment. The increased productivity, while not quantifiable at this time, will offset cost by implementing time-saving, enhanced document-tracking capabilities.

Summary Analysis

The recommendations in this report will reduce the number of processing days from 14 to 5 days as summarized in **Exhibit 1-15**. The detailed strategy for each reduction is shown in **Exhibit 1-16**.

**Exhibit 1-15
Requests for Council Actions
Projected Reduction of Processing Time**

Processing Component	Avg. Number of Days	Days Reduced	Revised Processing Days
1. Controller Process	5	(2.5)	2.5
2. Other Duties	3	(1.5)	1.5
3. Errors	<u>2</u>	<u>(1.0)</u>	<u>1.0</u>
Total	<u>10</u>	<u>(5)</u>	<u>5</u>

**Exhibit 1-16
Detail for Reducing Processing Time**

Processed/ Error/Duties	Current Avg. Days	Strategy for Reducing Time/Error	Days Reduced	Reason
<u>1. Controller Process</u>				
Deputy Controller signature	1	Eliminate requirement.	1	Sufficiently reviewed by Processor, Accounting Supervisor, and Director of Operations.
Enter tracking log data	1	Electronic system	.5	System will maintain log and status.
Review and approval	1.5	Thresholds, training	.5	Reduces volume by 20%, reduces errors.
Other procedures	1.5	Eliminate review of general contract terms, ink imprints, thresholds.	.5	Review exceeds requirements, ink imprint is redundant.
Total	<u>5</u>		<u>2.5</u>	
<u>2. Other Duties</u>				
Establish budgets after ordinance approved, maintain contract history and status activity, and process Supplemental Allocation Letters	3	Reassign job duties.	1.5	One processor would work on RCA processing full time.
<u>3. Error Description</u>				
Insufficient Funds	.5	Dept. applies RX approval Training Thresholds.	.5	Reserve funds at point of origination.
RX Missing	.5	Dept. applies RX approval Training.	.5	Rely on electronic approval as verification of RX.
Missing signatures	.5	Electronic System training	-0-	Rely on electronic approval.
Different amounts	.5	Training	-0-	
Total	<u>2</u>		<u>1.0</u>	

Assumptions

1. The average number of days for Deputy Controller approval is assumed to be one day to allow for any special situations or unknown errors in data used for calculation.
2. The electronic system includes a tracking system. The average number of days for log entry, review and approval, and other procedures is based on estimates provided by staff.
3. The total average number of days to clear errors is based on estimates by staff. Detailed calculations by error type are based on the percentage of error category applied to the total average number of days for error processing.
4. The average number of days for other duties is based on the total average days to process less controller-processing days and error-processing days.

Chapter 2

PAYROLL CONTROL

This chapter of the report reviews the Payroll Control functions, which are part of the City of Houston Controller's (the Controller's) Operation Division. The chapter has been divided into two sections:

- A. Staffing and Operations
- B. Alternative Internal Control Method

The primary function of Payroll Control is to audit personnel actions for accuracy and compliance with City ordinances, ensure the accuracy of payroll check certifications, and ensure the accurate distribution of payroll checks.

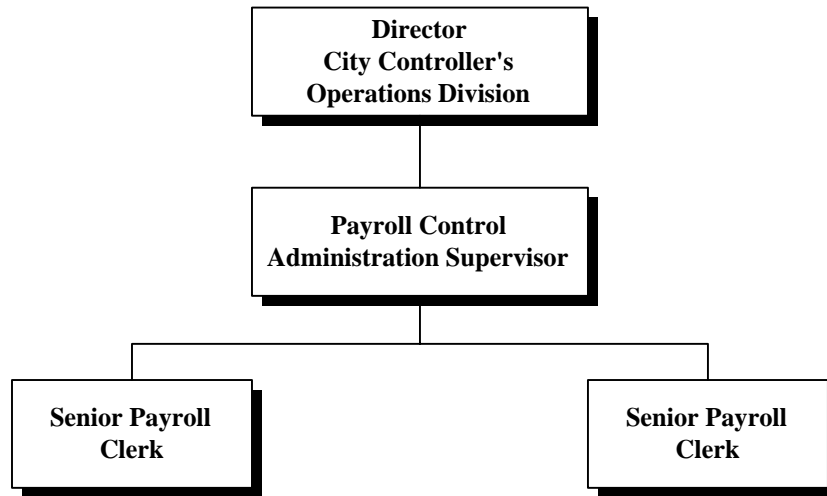
COMMENDATION

Payroll Control has continued to meet weekly payroll processing requirements even with the reduction of one staff. Employees within the Payroll Control unit are dedicated to ensuring high accuracy levels related to the internal control and certification function.

A. STAFFING AND OPERATIONS

Payroll Control reports to the Director of the Operations Division. The Payroll Control Administration Supervisor is responsible for handling day-to-day operations, which involves organizing workflow and responding to processing questions from departments, central payroll, and Payroll Control clerks. Two Senior Payroll Clerks who perform similar tasks support the Administration Supervisor. Major tasks conducted by the unit include performing accuracy/compliance audits for personnel action forms and issuing system approvals for processing; auditing payroll exceptions; auditing and approving supplemental payroll data; and, approving electronic disbursement vouchers. Payroll Control is also responsible for issuing manual payroll checks; performing electronic funds transfers for payroll; and, reconciling checks to the distribution log, and folding, scanning, and sealing payroll checks prior to disbursement to departments. **Exhibit 2-1** presents the organizational structure for the Payroll Control functions.

**Exhibit 2-1
Organizational Structure for
Payroll Control Functions**



Source: City of Houston Operations Division.

Exhibit 2-2 presents a summary overview of the major functions performed by Payroll Control.

**Exhibit 2-2
Summary Overview of
Major Payroll Control Processing Functions**

Major Payroll Control Function	Description
Audit Personnel Action (201) Forms	<ul style="list-style-type: none"> Confirms that an open and budgeted position is in place for new hires, rehires, promotions, and transfers.
Review Payroll Exceptions	<ul style="list-style-type: none"> Reviews employee's gross pay, such as overtime, shift differential, salary adjustment, or docked pay, primarily looking for over, under, or duplicate payments.
Audit Payroll Approval Forms	<ul style="list-style-type: none"> Reviews the accounting form used as approval to authorize the release of payroll and manual checks generated by the City's Information Services Division (ISD) of the Finance and Administration Department (F & A), for each department head to certify the accuracy of the payroll, and for authorized personnel to sign as receiver of payroll checks.
Scan, Fold, and Seal Checks	<ul style="list-style-type: none"> Reconciles checks to distribution log, scans, folds, and seals checks using automated machine.

**Exhibit 2-2 (Continued)
Summary Overview of
Major Payroll Control Processing Functions**

Major Payroll Control Function	Description
Audit Supplements	<ul style="list-style-type: none"> Reviews manual request for payment, usually generated by the employing department and forwarded to Central Payroll for processing. Supplements are processed for injury, new hires, rehires, terminations, pay adjustments, overtime, etc. Payroll Control audits the accuracy of pay rate resulting from supplemental pay.
Initiate Stop Payments	<ul style="list-style-type: none"> Verifies check information against applicable payroll register. Calls bank to verify if check has cleared. Faxes stop payment order to bank.
Review Electronic Disbursement Vouchers for Payroll Deductions	<ul style="list-style-type: none"> Reviews payment vouchers for each deduction code (approximately 99 codes) initiated during the payroll period. Payroll Control compares payment vouchers to the deduction summary report and verifies payee, amounts, payroll ending date, fund, etc. Reviews deduction checks for each vendor prior to distribution.
Audit Termination Pay	<ul style="list-style-type: none"> Performs a complete audit for accuracy of sick and vacation pay that will appear on an employee’s final check.
Approve and Issue Manual Checks	<ul style="list-style-type: none"> Verifies payroll amounts and accompanying documentation submitted by central payroll and issues manual checks.
Audit Electronic Funds Transfer	<ul style="list-style-type: none"> Verifies payroll amount information submitted by central payroll and transmits electronic files to banks to fund payroll.

Source: Review Team.

FINDING

The City of Houston has two biweekly payrolls—the municipal payroll and the payroll for the Police and Fire Departments. Payroll Control is responsible for auditing these payrolls, which means that the unit audits at least one payroll weekly. An essential indicator for measuring operating efficiency and productivity of any function is accurate transaction volume indicators and statistics for output per employee. Manual logs for recording the number of transactions processed for each major audit function have been developed for Payroll Control, but these logs are not consistently maintained. For FY 1998-1999, transaction logs were maintained for only 11 of the 52 payrolls. No transaction logs were maintained for FY 1997-1998.

Exhibit 2-3 presents an example of a Payroll Control transaction log.

A key statistic that is not maintained by Payroll Control is the actual number of exception errors identified and the dollar amounts associated with those errors. If more detailed transaction processing data were maintained, the information could be used to assess the volume of work performed by Payroll Control, the dollar volume of errors, the efficiency of employees, and staffing requirements, based on workload.

Recommendation 2-1:

Record and maintain transaction volume for all major payroll control processing functions after each payroll cycle is completed; add monthly and year-to-date volume indicators; and, monitor the logs as a means of measuring exception volume and staff productivity.

Instead of using manual logs, an automated spreadsheet should be developed and payroll control transaction volume should be entered weekly into the spreadsheet. Columns should be included on the spreadsheet so that monthly and year-to-date transaction volume can be determined and error dollar volume can be calculated.

Although payroll control work activity overlaps among employees assigned to the unit, the Administration Supervisor should attempt to identify which work functions are performed by which employees so that production statistics per employee can be determined. **Exhibit 2-5** presents a suggested format for an automated transaction-processing log.

**Exhibit 2-5
Suggested Format for Payroll Control
Transaction Processing Log**

CITY OF HOUSTON
Operations Division
Transaction Processing Report
JULY 1999

Number/\$ Volume of Transactions by Transaction Type	Week of July-2, 1999	Week of July-9, 1999	Week of July-16, 1999	Week of July-23, 1999	Week of July-30, 1999	Previous Month Total	Prior YTD Total	YTD Total	Total Month- End Number Processed by Employee/3	YTD Total Number Processed by Employee/3
Personnel Actions Forms (201s)						-		-	-	-
Supplements						-		-	-	-
Payroll Adjustment Transactions (Prats)						-		-	-	-
Payroll Checks						-		-	-	-
Payroll Advices						-		-	-	-
Stop Payments						-		-	-	-
Vendor Checks						-		-	-	-
Wire Transfers						-		-	-	-
Payment Vouchers						-		-	-	-
Number of 201 Errors Identified										
Dollar Volume of Errors Identified on 201s										
Number of Termination Pay Errors						-		-	-	-
Dollar Volume of Termination Pay Errors						\$ -		\$ -	-	-
Number of Payroll Exception Errors						-		-	-	-
Dollar Volume of Payroll Exception Errors						\$ -		\$ -	-	-

Source: Review Team.

The revised transaction-processing log should be provided to the Director of the Operations Division weekly and used as a tool to manage Payroll Control operations.

IMPLEMENTATION STRATEGIES AND TIMELINE

1. The Director of the Operations Division directs the Payroll Control Administration Supervisor to develop a revised transaction-processing log using an automated spreadsheet. October 1999
2. The Payroll Control Administration Supervisor submits the transaction-processing log to the Director of the Operations Division on a weekly basis. October 1999
3. During weekly status meetings, the Director of the Operations Division and the Payroll Control Administration Supervisor use the transaction-processing log to measure and monitor efficiency, productivity, and required staffing levels. November 1999 and ongoing thereafter

FISCAL IMPACT

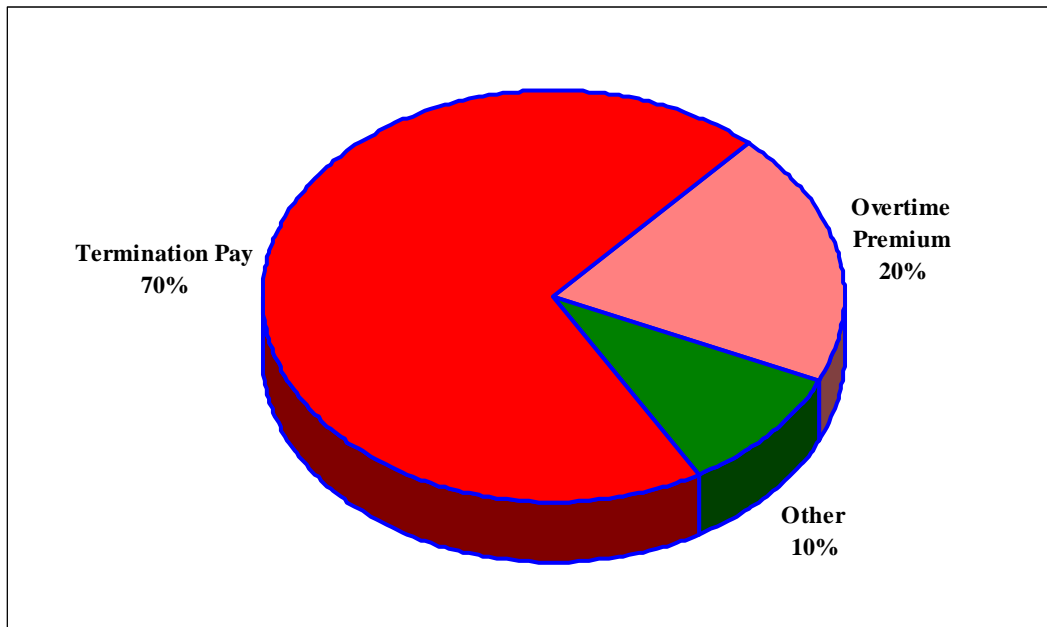
This recommendation can be implemented by Payroll Control staff at no cost to the Controller’s Office.

FINDING

Payroll Control staff identifies exception-processing errors by manually scanning three reports that are generated by the City’s Information Services Division of the Finance and Administration Department. These reports include the hours-to-gross report, the overtime exception report, and the termination report. The hours-to-gross report shows the hours and the hourly rate of pay for base pay and each pay category, such as vacation, sick, and overtime. The overtime exception report shows overtime, shift, dock, and positive pay hours for employees. The termination report shows all employees who are terminating employment with the City.

Although types and frequency of exception processing errors are not tracked by Payroll Control, the review team analyzed documentation that had been accumulated by the Payroll Control Administration Supervisor for 50 exception errors that occurred over an 18-month period (January 1997 through May 1998). **Exhibit 2-6** presents the most common exception errors based on the documentation maintained by the Administration Supervisor.

Exhibit 2-6
Common Exception Errors Identified by Payroll Control
By Pay Category



Source: Review Team.

Note: Termination pay may have the highest frequency error rate because Payroll Control targets this category.

The Payroll Control Administration Supervisor said that approximately 30 to 40 percent of the unit's time is spent on identifying exception processing errors. A significant portion of the time allocated to identifying exception-processing errors is spent on the termination pay category—about 70 percent of the exception error sample that was analyzed. Termination pay is targeted by Payroll Control because if a payroll processing error is made, it is difficult to recoup overpayments once an employee no longer works for the City. The other 30 percent of the sample involved exception-processing errors for overtime pay, duplicate pay transaction types processed on the same date, (e.g., an employee receiving 8 hours of vacation time and 8 hours of sick time on the same date) or error combinations for two or more pay categories (other).

Because a large number of City employees can have an exception to the normal payroll (i.e., any municipal employee who had normal hours worked entered incorrectly at the department level or Police or Fire Department employees who had a change in work schedule during the payroll cycle), manually scanning the exception reports does not yield a high accuracy rate for identifying potential errors. Exception errors could be identified more easily and a higher number of errors could be corrected if three additional exception reports were developed. **Exhibit 2-7** presents the type of data that should be presented in the three additional exception reports.

**Exhibit 2-7
Suggestions for Additional Payroll Exception Reports**

Exception Report Data Requirements
<ul style="list-style-type: none"> • Isolate duplicate transaction types on duplicate dates • Isolate employees going from parttime to fulltime and vice versa • Isolate employees who have a work schedule change within a payroll cycle

Source: Review Team.

Recommendation 2-2:

Work with the City’s Information Services Division of the Finance and Administration Department to develop additional payroll control exception reports to facilitate more efficient processing.

IMPLEMENTATION STRATEGIES AND TIMELINE

- | | |
|---|---------------|
| 1. The Payroll Control Administration Supervisor submits suggestions for exception report revisions to the Director of the Operations Division. | October 1999 |
| 2. The Director of the Operations Division meets with the Director of Information Services to review exception report revisions. | November 1999 |
| 3. The Director of Information Services (ISD) reviews requests and assigns the request for an ad hoc report to an ISD staff member. | December 1999 |
| 4. ISD completes the request for a revised ad hoc report. | January 2000 |

FISCAL IMPACT

This recommendation can be implemented with existing resources, as the City’s Information Services Division of the Finance and Administration Department can complete the requests for additional exception reports.

FINDING

Payroll Control is responsible for auditing the accuracy of personnel action forms which involves confirming that an open and budgeted position is in place for new hires, rehires, promotions, and transfers. According to the Payroll Control Administrative Supervisor, auditing personnel action forms (201 forms) consumes about 20 percent of the unit's time. During FY 1998-1999, Payroll Control audited about 479 personnel action forms per week or nearly 25,000 forms for the year.

The review team identified two issues related to the 201 form audit process. First, Payroll Control does not track error rates or the dollar volume of errors identified during the audits. As a result the audits are not as effective as they could be.

Second, the 201 form audit process seems to span beyond the intent of ensuring adequate internal control of disbursements related to payroll. The City Controller's Office is only accountable for ensuring that *financial disbursement transactions* are properly authorized in compliance with the City administrative and accounting procedures, recorded accurately, and properly executed and distributed to a vendor or employee. Prior to Payroll Control auditing the 201 forms they have already been reviewed by both the initiating department, Central Payroll in the Finance and Administration Department, and the Human Resource Department. Since the Payroll Control unit's audit of personnel action forms *does not result in a direct financial disbursement* to an employee and mainly consists of *re-verifying* that funds exist for open positions, this function could be considered duplicative or nonessential.

Recommendation 2-3:

Track 201 form error rates for six-months and migrate toward eliminating the process of auditing 201 forms altogether.

Payroll Control should begin tracking 201 form error rates immediately. The revised transaction log proposed in **Exhibit 2-5** should be used to track the error rates. From the transaction log, Payroll Control should accumulate documentation showing the source (departments), type, and frequency of errors. This documentation should be provided to departments, Central Payroll in the Finance and Administration Department, and the Human Resource Department so that corrective action plans can be developed to minimize errors on the 201 forms. Once Payroll Control has provided summary documentation of 201 form error rates and informed the appropriate parties that corrective action plans should be developed to minimize errors, the Controller's Office should eliminate the process of auditing 201 forms altogether. Total elimination of auditing 201 forms should begin at the start of FY 2001.

To ensure that adequate internal controls are in place to confirm that open and budgeted positions are available for new hires, rehires, promotions, and transfers, Payroll Control should verify funding for all budgeted positions at the beginning of each City budget cycle. Payroll Control should then rely on the accuracy of personnel changes made by the initiating departments and the Human Resource Department throughout the fiscal year.

IMPLEMENTATION STRATEGIES AND TIMELINE

- | | |
|---|--------------------------------|
| 1. The Director of the Operations Division instructs the Payroll Control Administrative Supervisor to track 201 form error rates for a six-month period and provide a report of the results. | September 1999 –
March 2000 |
| 2. The Director of the Operations Division provides summary documentation of 201 form error rates and informs departments, Central Payroll in the Finance and Administration Department, and the Human Resource Department that corrective action plans should be developed to minimize errors. | April 2000 |
| 3. The City Controller (Deputy) informs departments, Central Payroll in the Finance and Administration Department, and the Human Resource Department that Payroll Control will no longer perform the function of auditing 201 forms, effective FY 2001. | May 2000 |
| 4. The City Controller (Deputy) instructs Payroll Control to verify funding for all budgeted positions at the beginning of each City budget cycle to ensure adequate internal controls are in place to confirm open and budgeted positions are available for new hires, rehires, promotions, and transfers. | July 2000 |

FISCAL IMPACT

Full implementation of this recommendation should decrease Payroll Control's weekly workload by 20 percent.

FINDING

During FY 1996-1997, the City Controller's Office engaged an external consultant to conduct a performance review of the Financial Disbursement Division, which included Payroll Control. At the time of the performance review, Payroll Control was staffed with a Payroll Control Accountant and three payroll clerks. At the conclusion of the performance review, it was recommended that one payroll clerk's position be eliminated. One of the objectives of this "Contract Certification and Payroll Control Process Review" was to determine if there is a staffing need for the payroll clerk's position that was eliminated during the previous review.

Our review of the Payroll Control indicates that the unit can operate efficiently with existing staffing levels by implementing **Recommendations 2-1** through **2-3** contained in this section of the report. A summary of these recommendations follows:

- Record and maintain transaction volume for all major payroll control processing functions after each payroll cycle is completed; add monthly and year-to-date volume indicators; and, monitor the logs as a means of measuring exception volume and staff productivity.
- Work with the City's Information Services Division of F & A to develop additional payroll control exception reports to facilitate more efficient processing.

- Track 201 form error rates for six-months and migrate toward eliminating the process of auditing 201 forms altogether.

Recommendation 2-4:

Maintain current Payroll Control staffing level by implementing Recommendations 2-1 through 2-3.

IMPLEMENTATION STRATEGIES AND TIMELINE

1. The Director of the Operations Division implements Recommendations **2-1** through **2-3** as a means of improving Payroll Control operating efficiency and maintaining staff at existing level. January 2000
2. The Director of the Operations Division continues to monitor operational statistics and staff productivity. January 2000 and ongoing

FISCAL IMPACT

This recommendation can be implemented with existing resources.

B. ALTERNATIVE INTERNAL CONTROL METHOD

FINDING

The Controller’s Office may be performing more payroll control functions than the Charter Code of Ordinance requires.

Article I, Section 14-13 of the Charter Code of Ordinances (Compiling, checking, certifying, and correcting payrolls) states that ...

- (a) It is the responsibility of every department head to compile all payrolls as promptly as possible, and to deliver same to the office of the civil service commission (the Director of Human Resources as the Secretary for the Civil Service Commission) in good order, properly signed and ready for the **city controller**. It shall be the duty of each department to furnish one employee to deliver such payrolls, which employee shall assist the civil service commission (the designated payroll administrator for each department) in the checking of that department’s payroll at the time same is delivered.
- (b) It shall be the duty of the civil service commission (the Director of Human Resources as the Secretary for the Civil Service Commission) to check all payrolls to determine the legality of employment. Each item shall conform to the civil service records (Central Payroll in the Finance and Administration Department).

- (c) Payrolls checked under this section shall be certified in writing by the human resources director and, when checked by another employee of the commission (Assistant Director(s) of the Human Resources Department), shall bear the initials of the employee checking the same.
- (d) After payrolls have been checked and certified by the commission (the Director of Human Resources), they shall be delivered immediately to the **city controller**.
- (e) When items on any payroll are found to be incorrect and are red-lined, the same shall be corrected by the department before the payroll is certified by the commission. No payroll shall be honored by the **city controller** which has not been first checked and found to be correct by the commission (the Director of Human Resources).
- (f) It shall be the duty of the civil service commission (the Director of Human Resources) to notify the head of any city department if any irregularity, mistake, or error is found in the names or in the amount of compensation on any payroll, and to refuse to certify to the correctness of such payroll until the mistake or error is rectified. All heads of departments, when notified of such irregularity or error, by telephone or otherwise, shall at once rectify same, in order to facilitate the work of certifying to the correctness of any such payrolls.

The Charter Code of Ordinances requires only that after payrolls have been checked and certified by the commission (the Director of Human Resources), they should be delivered immediately to the City Controller. The Code of Ordinances goes on to say that no payroll should be “honored or processed” by the Controller that has not been first checked and found to be correct by the commission (the Director of Human Resources). The Charter Code of Ordinances does not specifically state that the Controller’s Office must certify that the City’s Payrolls are correct. In fact, a separate internal control function to certify payroll accuracy is uncommon in both the private sector and city government. Most entities require that payroll accuracy be verified at the departmental processing level.

As part of the Payroll Control review, the 10 largest cities across the country were surveyed to identify “best practice” models for payroll control. Seven of the 10 largest cities participated in the benchmark survey. Survey participants included:

- Chicago
- Los Angeles
- Philadelphia
- Detroit
- Dallas
- Phoenix
- Atlanta

Of the seven cities that participated, central payroll is processed in the Finance Department (similarly to Houston) in only three cities—Philadelphia, Detroit, and Phoenix. In Atlanta, the Employee Benefits Division of the Finance Department processes central payroll. The Controller processes central payroll in—Chicago, Los Angeles, and Dallas.

The most significant benchmark survey finding was that only one of the seven cities (Philadelphia) has a separate (day-to-day) payroll control function external to the department that is responsible for processing the central payroll. The remaining six cities rely on departments and central payroll to ensure payroll accuracy and perform internal control functions. Dallas and Phoenix use dollar thresholds for net pay for individual employees during each payroll cycle as the primary means of identifying payroll control. These employee net pay amounts are \$4,000 and \$6,500 respectively, for the two cities. Dallas

and Phoenix also conduct internal audits of the payroll function at least once a year. On occasion, Houston performs payroll administration audits through the City Controller's Audit Division. However, payroll administration audits are not part of Houston's regular internal audit plan, and a payroll administration audit has not been conducted in the past three to four years. Los Angeles refers all unusual exceptions to internal audit and audits each department for accuracy levels of payroll input once every two years.

The benefit of having the Controller's Office Audit Division perform the payroll control process is that auditors are trained to use statistical sampling techniques that are capable of extrapolating error rates over a large number of transactions within departments.

The City of Houston's Payroll Control unit presently scans exception reports for errors, which is not as systematic. While immediate identification and correction of payroll errors identified by Houston's Payroll Control unit would no longer be accomplished, by performing payroll control through the internal audit function, Controller's Office Audit Division could achieve a higher confidence level for payroll accuracy overall.

Exhibit 2-9 presents the Payroll Control benchmark survey data for the seven cities that participated.

**Exhibit 2-9
Payroll Control
Benchmark Survey Data – June 1999**

City	Houston	Chicago	Los Angeles	Philadelphia	Detroit	Dallas	Phoenix	Atlanta
Number of Full-time Employees	22,000	38,000	33,000	25,000	17,427	13,272	11,975	7,500
Number of Part-time Employees	3,000	2,000	8,000	No Response	566	1,026	750	500
Frequency/Description of Payroll Processing Cycles	<i>Weekly</i> Police and firemen are paid every other week. All other principal employees are paid every week.	<i>Weekly</i> Police and firemen are paid every other week.	<i>Biweekly</i> All employees are paid on same day, no staggering-one payroll every two weeks.	<i>Weekly</i> Police and firemen are paid every other week. All other principal employees are paid every week.	<i>Biweekly</i> All employees are paid on same day, no staggering-one payroll every two weeks.	<i>Weekly</i> Police and firemen are paid every other week. All other principal employees are paid every week.	<i>Biweekly</i> All employees are paid in the same day every other week.	<i>Weekly</i> Elected officials are paid monthly. All other employees are paid on weekly staggered cycles.
Department Responsible for Processing Central Payroll	Finance and Administration	Controller	Controller	Finance	Finance	Controller	Finance	Employee Benefits Division of Finance Department
Department Responsible for Payroll Control	Controller	Controller	Controller	Controller	Finance	Controller	Finance	Finance

**Exhibit 2-9
Payroll Control
Benchmark Survey Data – June 1999 (Continued)**

City	Houston	Chicago	Los Angeles	Philadelphia	Detroit	Dallas	Phoenix	Atlanta
Major Internal Control Functions Performed:	No	Yes	Yes	Yes	No P/R section within Human resources perform task and Every single timesheet is matched to the pay register.	Yes	Yes	Yes
• Reconcile Time	Individual Departments	Individual Departments	Individual Departments	Individual Departments	Individual Departments	Individual Departments	Individual Departments	Individual Departments
• Review for Excess Overtime	Individual Departments	Individual Departments	Individual Departments	Individual Departments	Individual Departments	Individual Departments	Individual Departments	Individual Departments
• Review for Overpay	Individual Departments	Process Payroll	Process Payroll	Process Payroll	Process Payroll	Process Payroll	Process Payroll	Process Payroll
Major Centralized Payroll	Processing Payroll	Reconcile total payroll, deductions, due benefits. Treasury distributes checks.	Reconcile total payroll deductions, benefits, prepare and distribute checks, wire transfers, EFT.	No response.	Reconcile total payroll, deductions, benefits, prepare and distribute checks, wire transfers, EFT.	Reconcile total payroll, deductions, benefits, prepare and distribute checks, wire transfers, EFT.	Reconcile total payroll, deductions, benefits, prepare and distribute checks, wire transfers, EFT.	Reconcile total payroll, deductions, benefits, prepare and distribute checks, wire transfers, EFT.
Payroll Control Performed by Centralized Payroll Only	No	Yes	Yes	No	Yes	Yes	Yes	Yes

**Exhibit 2-9
Payroll Control**

Benchmark Survey Data – June 1999 (Continued)

City	Houston	Chicago	Los Angeles	Philadelphia	Detroit	Dallas	Phoenix	Atlanta
Central Payroll Utilizes Automated Exception Reports to Identify Exceptions	No	Yes	Yes	Yes	No Rely on review of timesheets by payroll in human resources as described in 6 above.	Yes	Yes	No. Rely on departments to identify exceptions.
Dollar Thresholds Established to Facilitate Payroll Exception Processing	None	None	None	None	None	Employees receiving net pay of \$4,000 or higher are reviewed monthly.	Employees receiving net pay of \$6,500 or higher are reviewed monthly.	None
Other Internal Controls Established	The Controller's Office internal audit function sometimes performs payroll administration audits, but none has been performed in the last 3 to 4 years.	None	Unusual exceptions are referred to Internal Audit. Internal Audit also audits each department for accuracy levels of payroll input at least once every two years.	None	None	Internal and external audits of payroll occur at least once per year.	Internal Audit audits payroll annually.	None

Source: Review Team.

Note: EFT = Electronic Funds Transfer.

Recommendation 2-5:

Revise the Controller's Office internal audit plan to include targeting the accuracy of payroll input at the department level and central payroll processing accuracy levels. Depending on dollar volume risk identified, transfer appropriate payroll control functions to the Internal Audit Division.

The Director of the Operations Division should recommend that the Controller's Office Audit Division conduct a detailed payroll audit at the department level for at least 5 of the City's 21 departments and on central payroll during FY 1999-2000 and again during FY 2000-2001. The revised Payroll Control transaction log(s) shown in **Exhibit 2-5** should be used to as a starting point to determine departments and transaction types with high error frequency. Once the payroll audits are complete, the Controller's Office should then evaluate the potential dollar volume loss identified using the internal audit process and compare these amounts to the administrative cost of maintaining a separate Payroll Control function. If the cost of maintaining the payroll control function is higher than the potential dollar volume loss identified through the internal audit process, the payroll control function should be eliminated.

Some payroll control functions (i.e., reviewing termination pay and preparing payroll disbursement vouchers and vendor checks) will still need to be continued by staff in the Controller's Office even if the payroll control function proves not to be cost-effective. These functions should be reassigned as necessary.

IMPLEMENTATION STRATEGIES AND TIMELINE

- | | |
|---|------------------|
| 1. The Director of the Operations Division recommends that the Controller's Office Audit Division prepare an audit plan to review accuracy levels of payroll input at the department level and for central payroll. | January 2000 |
| 2. The Controller's Office Audit Division staff implements and executes the audit plan. | March – May 2000 |
| 3. The Controller's Office Audit Division staff evaluates the risk associated with eliminating the Payroll Control function. | May 2000 |
| 4. Based on financial risk, the Controller's Office Audit Division staff makes a recommendation to handle payroll control through internal audit or to maintain the existing Payroll Control unit. | May 2000 |

FISCAL IMPACT

This recommendation can be implemented with existing resources.

EXHIBIT 1



OFFICE OF THE CONTROLLER
CITY OF HOUSTON
TEXAS

SYLVIA R. GARCIA

October 5, 1999

Sharon E. Murphy
McConnell, Jones, Lanier & Murphy, LLP
Summit Tower
11 Greenway Plaza, Suite 2902
Houston, Texas 77046

Dear Ms. Murphy:

I want to take this opportunity to thank you for the *Contract Certification and Payroll Control Process Review*.

We have completed our review of the Final Report and concur with your findings and recommendations. I can assure you that we will be taking the necessary steps to improve our procedures.

You and your team were very thorough in your review and comments, and my staff was very complimentary of the high degree of professionalism and openness during the entire process. Again, thank you.

Sincerely,


Sylvia R. Garcia
City Controller

Views of Responsible
Officials

SRG:ss

cc: Judy Gray Johnson
Claude Hill
Steve Schoonover