FINANCE AND ADMINISTRATION GOVERNANCE

Report: 2016-03

Issue Date: January 12, 2016

TABLE OF CONTENTS
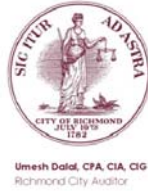
Richmond City Council
The Voice of the People   Richmond, Virginia

Office of the City Auditor

Umesh Dalal, CPA, CIA, CIG
Richmond City Auditor

Executive Summary

January 12, 2016

The Honorable Members of the Richmond City Council
The Honorable Mayor Dwight C. Jones

Subject: Non-audit Service - Governance Survey of Finance and Administration portfolio

At the request of the former Deputy Chief Administrative Officer (DCAO) of Finance and Administration, the City Auditor's Office conducted a governance survey in his portfolio using the Government Accountability Office's (GAO) guidance in their publication called the "Green Book." The primary objective of this survey was to identify gaps in the City's governance practices and communicate the observations to the DCAO for further action.

The Green Book includes five elements of internal control structure:

1. Control Environment: sets the tone of an organization by providing a foundation to the internal control system
2. Risk Assessment: establishing objectives linked to all organizational levels
3. Control Activities: establishing policies and procedures to ensure that management directions are carried out to achieve the City's goals and objectives
4. Information and Communication: identifying, capturing and communicating pertinent information in a form and timeframe that enable people to carry out their responsibilities
5. Monitoring: a mechanism for ongoing monitoring of actual performance throughout the organization over a period of time

The above components are interdependent and must coexist for the City to meet expectations of prudent management of public resources. Managers in the Finance and Administration portfolio identified the following issues, which they thought need addressing:

- **Recruitment and Retention of Competent Staff**
  The managers identified issues with establishing expectations of competence for employees in key roles. They feel quantifiable and measurable goals and objectives are not

always established for all key employees. The goals and objectives are not measured and evaluated against established criteria consistently. The employees in key positions do not always possess the skill set, knowledge, education, and experience to provide proper oversight. Also, the employees may need more training to carry out their responsibilities.

- **Exercising Oversight Responsibility**

  If the competence of the staff cannot be assured, the staff may need additional supervision and oversight. For that purpose, the City needs to have appropriate processes to ensure the quality of the work accomplished. About 40% of managers were of the opinion that the City could improve oversight processes. They do not feel that the requirements for complying with regulations, laws and policies are adequately defined. They do not seem to think that the procedures are documented to evaluate and manage performance of functions and employees. The departments need to establish operational goals and objectives and develop strategies to accomplish them.

- **Identifying, Analyzing, and Responding to Change**

  Most of the managers indicated a need for improvement in processes to deal with significant changes. More analysis and planning may be needed to address the impact of these changes.

- **Enforcing Accountability**

  Most of the managers indicated that constant change in leadership is impacting their operations. The employees are slow to react to any policy changes as they expect turnover in leadership, which may cause change in direction.

- **Technology**

  Most departments are still trying to get acclimated with the City's financial system, RAPIDS. Several managers indicated lack of complete data required to manage their operations.

- **Defining and Achieving City's Goals and Objectives**

  When asked, several managers did not have knowledge of the City's goals and objectives and processes to achieve those goals and objectives. They were not aware if functional goals and objectives are properly aligned with the City's goals and objectives.

- **Accomplishment of Assigned Responsibilities**

  Approximately 50% of managers indicated that in their department, responsibility for employees in key roles has not been defined properly. They also think that procedures do not include verification of accomplishment of assigned responsibilities.

As agreed with the Former DCAO of Finance and Administration, the report is prepared for management information and does not make any recommendations. The information included above should be used to validate the discrepancies and improve City operations.

Sincerely,

Umesh Dalal

Umesh Dalal, CPA, CIA, CIG
City Auditor

cc: Selena Cuffee-Glenn, Chief Administrative Officer
        The Richmond City Audit Committee
        Lenora Reid, Deputy Chief Administrative Officer of Finance and Administration

About this Project

The City Auditor's Office has completed a governance survey with several managers within the Finance and Administration portfolio. Over the past nine years we have identified many control and management deficiencies. In addition, various investigations conducted by the Office of the Inspector General have identified incidences of fraud, waste and abuse. The existence of unethical practices have also been noticed. In order to determine the root cause of these deficiencies, the City Auditor teamed up with the former Deputy Chief Administrative Officer (DCAO) of Finance and Administration to conduct a governance survey in his portfolio using the Government Accountability Office's (GAO) guidance in their publication called the "Green Book." This project was a non-audit service, which was conducted at the request of the former DCAO. The primary objective of this survey was to identify gaps in the City's governance practices and communicate the observations to the DCAO for further action.

In the near future, similar surveys must be conducted for the remaining portfolios and among leadership in the City in order to determine the gaps in the governance practices. This type of information will allow the future administration to initiate and complete corrective actions on a citywide basis.

Introduction and Methodology

According to the Government Auditing Standards promulgated by GAO, "The concept of accountability for use of public resources and government authority is key to our nation's governing processes.

Management and officials entrusted with public resources are responsible for carrying out public functions and providing service to the public effectively, efficiently, economically, ethically, and equitably within the context of the statutory boundaries of the specific government program."

Senior government executives have strived to find ways to better control the organization they are responsible for. Internal controls are put in place to ensure their goals and objectives are achieved by providing accountability and transparency in government operations which exist to serve the public with public resources. Internal controls promote efficiency, effectiveness, reduce risk of asset loss, and help ensure compliance with laws and regulations. In addition, proper checks and balances deter unethical behavior.

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) had issued a guidance for internal controls in 1992, which was widely accepted and used by public and private sectors. In 2013, COSO updated its internal control guidance, which was adopted by the GAO.

METHODOLOGY

- The City Auditor's Office reviewed the GAO Green Book consisting of COSO revised guidance. Researched COSO principles and related literature.
- Prepared a questionnaire using the information identified.

- Interviewed 21 managers at various organizational levels within the following departments:
  - Finance
  - Budget
  - Procurement
  - Informational Technology
- Analyzed results of the survey.

Background

Internal Control

Internal controls are processes designed to provide reasonable assurance regarding:

1. Effectiveness and efficiency of operations.

2. Reliability of financial reporting.

3. Compliance with applicable laws and regulations.

According to the GAO, "The internal control system is intertwined with the entity's operating activities and exists for fundamental business reasons. Internal control is most effective when controls are built into the entity's infrastructure and are a part of the essence of the enterprise. "Built in" controls support quality and empowerment initiatives, avoid unnecessary costs and enable quick response to changing conditions." According to COSO, internal control consists of five interrelated components as depicted in the following figure:

.

Categories of Objectives

Internal Controls
Components

The following is the description of the internal controls components as applicable to the City of Richmond:

1. Control Environment

The control environment sets the tone of an organization by providing a foundation to the internal control system. It provides discipline and structure for effective governance of an organization by achieving its objectives. The control environment includes:

- Integrity
- Ethical values
- Competence of the government employees
- Management's philosophy and operating style

Control environment refers to "Tone at the Top." Employees in any organization follow their leaders in their behavior and performance. In the City of Richmond, the City Council, the Mayor and the top

administration consisting of the CAO and DCAOs, establish the "Tone at the Top."

COSO principles related to the control environment are as follows:

1. The oversight body [the City Council] and management [Mayor and CAO] should demonstrate commitment to integrity and ethical values.

2. The oversight body should oversee the entity's [City's] internal control system.

3. Management should establish organization structure, assign responsibility and delegate authority to achieve the entity's objectives.

4. Management should demonstrate commitment to recruit, develop, and retain competent individuals.

5. Management should evaluate performance and hold individuals accountable for their internal controls responsibilities.

2. Risk Assessment

Every entity faces a variety of risks in achieving their objectives. For example, the City of Richmond faces a variety of risks, such as:

- Fiscal inadequacy
- Legal and regulatory compliance
- Reputational risks
- Strategy weakness or failure

Risk assessment consists of establishing objectives linked to all organizational levels and these objectives must be consistent and

interdependent. Risk assessment is the identification and analysis of risks that would prevent an organization from achieving its objectives and to provide guidance in managing those risks. As economic, regulatory and operating environment is subject to continuous change, risk assessment provides a mechanism to deal with the risks emerging from change.

COSO principles related to risk assessment are as follows:

6. Management should define objectives clearly to enable identification of risks and define risk tolerances.
7. Management should identify, analyze, and respond to risks related to the defined objectives.
8. Management should consider potential for fraud when identifying, analyzing, and responding to risks.
9. Management should identify, analyze, and respond to significant changes that could impact the internal controls system.

3. Control Activities

Control activities consist of the policies and procedures to ensure that management directions are carried out to achieve the City's goals and objectives. In addition, these activities mitigate risks faced by the City. Control activities must be adopted for all City departments, functions and associated entities. These processes include activities such as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets and segregation of duties.

COSO principles related to control activities are as follows:

10. Management should design control activities to achieve objectives and respond to risks.

11. Management should design the entity's information system and related control activities to achieve objectives and respond to risks.

12. Management should implement control activities through policies.

4. Information and Communication

An organization as complex as the City of Richmond, needs to identify and track information pertaining to its operations. This is the most effective way to validate if the organization operates in conformity with the goals and objectives identified by the leadership. It also will help assess the organizational performance in serving the resident of Richmond. The information must flow both ways, upward and downward, to help provide proper guidance to the workforce and for management to make effective decisions. The organization must identify, capture and communicate pertinent information in a form and timeframe that enable people to carry out their responsibilities. An organization's information systems produce reports, containing operational, financial and compliance-related information. This makes it possible to run and control the business. Effective communication in an organization must occur in a broader sense, flowing up, down and across. Personnel must have a clear understanding of their roles, duties, and responsibilities in an organization. They must have a clear means of communicating significant information upstream.

COSO principles related to information and communication are as follows:

13. Management should use quality information to achieve the entity's objectives.

14. Management should internally communicate the necessary quality information to achieve the entity's objectives.

15. Management should externally communicate the necessary quality information to achieve the entity's objectives.

5. Monitoring

In complex organizations like the City of Richmond, there must be a mechanism for ongoing monitoring of actual performance throughout the organization over a period of time. In addition, it will enable management to evaluate the quality of performance by organizational units such as agencies, departments, divisions, functions, etc. The management and supervisory processes must identify operational and compliance discrepancies and address effectively in a timely manner. Internal control deficiencies need to be communicated upward to various layers of management as required. Serious matters must be reported to the CAO, the Mayor or to the City Council as needed.

COSO principles related to monitoring are as follows:

16. Management should establish and operate monitoring activities to monitor the internal control system and evaluate the results.

17. Management should remediate identified internal control deficiencies in a timely basis.

COSO Components and Governance

The above components are interdependent and must coexist for the City to meet the Public's expectations of prudent management of their resources, and effective and efficient delivery of services in an expedient and economical manner. For this purposes, the leadership must establish operational, reporting, and compliance objectives. The operational objectives help the leadership in accomplishing the mission of the entity. Reporting components ensure communication to external as well as internal stakeholders. Compliance objectives facilitate compliance with laws, regulations, and policies.

Who is Responsible for Governance at the City?

At the City, leadership is responsible for the City's governance. Each component of the City leadership plays a role as follows:

MANAGEMENT

The CAO and her team consisting of the DCAOs and department directors, play a significant role in the governance of the City. This group is responsible for adequate management of the City's operations in meeting the residents' needs for services and safety. This group "owns" the system of delivering services and meeting stakeholders' expectations. As described before, this leadership segment is responsible for largely establishing the "Tone at the Top."

The CAO is ultimately responsible to the Mayor and the City Council for the results of operations of the City. The CAO must provide direction to the DCAOs and review their handling of operations in their respective

portfolios. The DCAOs, in turn, do the same for the directors reporting to them. This group play a significant role in ensuring that adequate information for proper management and monitoring is captured, analyzed and communicated to the Mayor, the City Council and the City's workforce in a timely manner.

MAYOR

According to the City Charter, "The mayor shall be the chief executive officer of the city and shall be responsible for the proper administration of city government…..

(b) Keep the council advised of the financial condition and the future needs of the city and of all matters pertaining to its proper administration, and make such recommendations as may seem to the mayor desirable;

(c) Oversee preparation of and submit the annual budget to the council as provided in Chapter 6 of this charter;"

The CAO is accountable and receives direction from the Mayor.

CITY COUNCIL

According to the City Charter, the City Council is "To provide for the organization, conduct and operation of all departments, bureaus, divisions, boards, commissions, offices and agencies of the city." Thus, the City Council is a policy making body.

INTERNAL AUDITORS

The City Auditor's Office and the Office of the Inspector General conducts ongoing audits and investigations to evaluate the City

operations and to communicate pertinent information related to deficiencies and ways to mitigate those deficiencies to the City leadership and the stakeholders. Because of organizational position and authority in the City, the City Auditor's Office plays a significant monitoring role.

OTHER PERSONNEL

All the City employees are responsible for communicating problems in operations, noncompliance with the laws, regulations and policies, fraud, waste, abuse, illegal actions, etc. Several external entities contribute in achieving the City's goals. For example, the City's external auditors provide assurance to the City leadership and citizens as to whether the financial statements are presented fairly. Others that can affect internal controls and the City's governance are legislators and regulators, customers, vendors, bond rating agencies, lenders, financial institutions, etc.

Results

WHERE DO THE GAPS EXIST?

During this process, 21 managers in the Finance and Administration portfolio were interviewed. The control weaknesses were rated in accordance with the number of managers expressing their dissatisfaction.

Priority Issues

Managers felt that controls are operating adequately for nine of the 17 principles. The managers found priority issues with controls associated with the remaining eight principles.

Recruitment and Retention of Competent Staff

COSO principle stipulates that management should demonstrate commitment to recruit, develop, and retain competent individuals. According to the Green Book, holding individuals accountable to established policies by evaluating personnel's competence is integral to attracting, developing, and retaining individuals. Past audits and external or internal evaluations have identified issues with compliance with policies and employee accountability. The managers identified issues with establishing expectations of competence for employees in key roles. They feel quantifiable and measurable goals and objectives are not always established for all key employees. The goals and objectives are not measured and evaluated against established criteria consistently. They also identified a need for recruiting, developing, and retaining competent personnel. Employees in key positions do not always possess the skill sets, knowledge, education, and experience to provide proper oversight. Also, the employees may need more training to carry out their responsibilities. The managers feel that their respective department either don't have merit based processes for hiring and advancing employees or they don't follow the processes. This may be impacting the quality of service the City is delivering to its residents.

Most of the managers indicated that the City does not have proper succession planning. Therefore, talents lost due to employee turnover may not be replaced in a timely manner, creating a gap in managing operations and delivering of services.

Currently, the City Auditor's Office is auditing the City's employee recruitment and retention function. Recommendations in this audit will assist management in dealing with this issue.

Exercising Oversight Responsibility

If the competence of the staff cannot be assured, the staff may need additional supervision and oversight. For that purpose, the City needs to have appropriate processes to ensure the quality of the work accomplished. About 40% of managers were of the opinion that the City could improve oversight processes. They do not feel that the requirements for complying with regulations, laws and policies are adequately defined. They do not seem to think that the procedures are documented to evaluate and manage performance of functions and employees. The departments need to establish operational goals and objectives and develop strategies to accomplish them. Once established, the accomplishment of objectives must be verified periodically to ensure that departments are accomplishing their stated responsibilities. Several functions are in the process of updating their policies and procedures. Without updated policies and procedures, proper guidance in carrying out job duties may not be available and newer staff may not be effectively trained when employee turnover occurs.

Identifying, Analyzing and Responding to Change

In recent past, the City has experienced significant turnover in leadership positions. Whenever there is turnover in leadership positions, there is a potential for change in the direction of operations, which represents a significant change. The City had a 13.2% employee turnover rate in FY14. The leadership and staff turnover impacts the City operations. In

addition, it is well known that there have been issues with the implementation of the ERP system. The employees did not receive proper training to use the system and the system may have configuration issues for effective use. This situation may have an impact throughout the City.

The majority of the managers did not have a good understanding about how to deal with significant changes encountered in the City's operation. Without an understanding of these changes, managers may not be equipped with the knowledge to mitigate their impact.

Most of the managers indicated a need for improvement in processes to deal with such significant changes. More analysis and planning may be needed to address an impact of these changes.

Enforcing Accountability

Management must evaluate employee performance in order to assure that the assigned job functions are accomplished in a timely and adequate manner. The survey found that evaluations for key employees have not been completed in over two to three years. The main reasons cited were frequent leadership changes as well as lack of performance measures to evaluate employee performance. The majority of the respondents also indicated that they are not in a position to offer incentives to employees to either perform better or reward exceptional performance. This may result in supervisors not being able to motivate employees to be accountable and perform better.

Most of the managers indicated that constant change in leadership is impacting their operations. The employees are slow to react to any policy changes as they expect turnover in leadership, which may cause

change in direction. Managers believe that departments are experiencing large turnover because employee do not feel appreciated. In recent years, the employees have not received any significant raises and opportunities for promotions are limited.

Technology

According to the Green Book, "Management designs the entity's information system to obtain and process information to meet each operational process's information requirements and to respond to the entity's objectives and risks...An information system represents the life cycle of information used for the entity's operational processes that enables the entity to obtain, store, and process quality information."

The information captured by the City must be complete, accurate, and valid. Without valid financial and operational data, pertinent decisions may not be made prudently.

Most departments are still trying to get acclimated with the City's financial system, RAPIDS. Several managers indicated lack of complete data required to manage their operations. Also, there may be a need for verifying the accuracy of the transactions entered into the computer systems. Due to lack of training and knowledge related to the system, some users have adopted manual methods to track information, which contributes to inefficiencies. Most of this information needs to be processed through RAPIDS.

Defining and Achieving City's Goals and Objectives

In a successful organization functional goals and objectives must be aligned with overall organizational goals and objectives. When asked, several managers did not have knowledge of the City's goals and objectives and processes to achieve those goals and objectives. They were not aware if functional goals and objectives are properly aligned with the City's goals and objectives. Educating managers and ensuring their agreement with the City's goals and objectives is critical for the City to accomplish its mission.

Accomplishment of Assigned Responsibilities

Half of the managers indicated that in their department, responsibility for employees in key roles has not been defined properly. They also think that procedures do not include verification of accomplishment of assigned responsibilities. This situation could result in the assigned tasks not being accomplished and hindering the functional performance.

Conclusion

Clearly, the managers at all levels were convinced that they need qualified and competent staff. There are several factors that impact the City's ability to recruit well suited staff and be able to retain them. This issue is currently being looked at in an audit of the City's recruitment and retention process. This audit will provide appropriate recommendations for dealing with these issues.

The need for verification of accountability of the City staff cannot be more emphasized. The City must enforce its policy to conduct

performance evaluation of employees. Proper guidance must be available for fair and objective performance evaluations.

The managers are not satisfied with the available technology. This dissatisfaction is largely due to the failed implementation of the City's financial system, RAPIDS.

Also, several managers could not clearly articulate the City's goals and objectives. Without this understanding, it may not be possible for them to align their operations' objectives to the City's goals and objectives. The risk is that some operational areas of the City may not conform and, therefore, may not achieve the City's goals and objectives.

Ethical behavior is critical for success of any organization. It appears that many managers did not understand the City's Ethics Policy completely. Therefore, it is conceivable that they may not be able to enforce this Policy.

As agreed with the Former DCAO of Finance and Administration, the report is prepared for management information and does not make any recommendations. The information included above should be used to validate the discrepancies and improve City operations.