



CITY OF NEWPORT BEACH FINANCE COMMITTEE STAFF REPORT

Agenda Item No. 5B
January 13, 2022

TO: HONORABLE CHAIRMAN AND MEMBERS OF THE COMMITTEE

FROM: Scott Catlett, Finance Director/Treasurer
949-644-3123, scatlett@newportbeachca.gov

SUBJECT: INTERNAL AUDIT PROGRAM REPORTS

SUMMARY:

In the spirit of continuous improvement and with support and direction from the City Manager's Office, the Finance Department was charged with developing an ongoing comprehensive internal audit program. Audit firm Moss Adams previously prepared a recommended internal audit program for Fiscal Year 2020-21 that focused on addressing priorities identified as part of the City's risk assessment and internal controls review. This report summarizes the internal audit activities and recommended improvement opportunities for three of the five internal control areas of focus recommended for Fiscal Year 2020-21. The final two reports for the Fiscal Year 2020-21 program are nearing completion, and staff anticipates presenting these reports to the Finance Committee in February.

RECOMMENDED ACTION:

Review and discuss the reports and provide recommendations for City Manager consideration.

DISCUSSION:

Background

While the City has managed a great many financial statement and compliance audits over the years, the City has not historically had a robust internal audit program. The current program was initiated in 2020 with an enterprise risk assessment and initial evaluation of internal control risks. These processes served as the primary building blocks to inform and develop a work plan to further assess and test internal controls, conduct performance audits, and provide management consulting services when appropriate. From this work plan, an internal audit program was developed for Fiscal Year 2020-21, and the remaining

components of the work plan that were not undertaken during Fiscal Year 2020-21 will be reviewed in future fiscal years.

Current Progress

Of the work plan components identified by Moss Adams, the Fiscal Year 2020-21 Internal Audit Program included the focus areas summarized in the table below, three of which (Nos. 1,4, and 5) have been recently completed, with assessments of areas 1 and 4 completed by audit firms Moss Adams and Macias Gini & O'Connell LLP (MGO), respectively, and an assessment of area 5 completed by the Assistant City Manager. Assessments of the remaining two focus areas are expected to be completed in January 2022, with the final summary reports anticipated to be presented to the Finance Committee in February 2022.

No.	Key Controls	Progress	Task Resource
1	Procurement Operational Review and Internal Controls Testing	Complete	MGO
2	Cash Handling Internal Controls Testing	Expected January 2022	Moss Adams
3	Information Technology Operational Review and Internal Controls Testing	Expected January 2022	Moss Adams
4	Fiscal Policy Inventory and Implementation Plan	Complete	Moss Adams
5	Inventory Management Internal Controls Testing	Complete	City Manager's Office

The final summary reports for the three completed assessment areas are included with this staff report, with the report for area 5 prepared by the City Manager's Office and the other two reports reviewed in detail by City staff. Detailed observations were provided to City staff in separate internal management reports for each assessment area with specific recommendations regarding opportunities for improvement in accordance with best practices.

An overview of each document is provided below.

Procurement Operational Review and Internal Controls Testing

City staff retained MGO to complete a review and assessment of the City's procurement operations, with objectives including:

- Solicit constructive, fact-based feedback on procurement challenges and opportunities;

- Evaluate the City's procurement and contracting functions relative to best practices and policies in peer agencies, including purchasing thresholds, internal controls, and policies and procedures;
- Review existing and/or recommend appropriate performance metrics to evaluate operational effectiveness and efficiency; and
- Provide recommendations for improvement opportunities and/or increased efficiencies, including identification of training and tools that can better aid departments on purchasing responsibilities and practices.

As part of this assessment, MGO reviewed existing policies, procedures, and workflows, reviewed the City's vendor contract for insurance certification, interviewed staff in twelve different departments, analyzed the results of these efforts, and prepared a final report summarizing the analysis and recommendations. As outlined in the final summary report, MGO summarized its recommendations to cover communication, documentation, and streamlining of processes. Key findings were as follows:

- Enhance communication protocols to include consistent and regular communication to departments on process changes or policy updates.
- Provide clear direction on the roles and responsibilities for participants in the procurement process.
- Update procurement and contracting policies and procedures to be consistent with one another as well as reflective of current practices.
- Increase the purchasing thresholds.
- Implement changes to streamline existing procurement processes.

City staff concurs with the findings and recommendations from MGO as outlined in Attachment A and has created a corresponding work plan for implementation of the recommendations, which considers the risk level and related priority of each improvement opportunity. Recommendations on policy changes, including updates to the purchasing thresholds, will be presented to the Finance Committee for consideration, and subsequently to the City Council for approval, prior to implementation. Staff currently anticipate presenting these recommendations to the Finance Committee in September 2022.

Fiscal Policy Inventory and Implementation Plan

Moss Adams completed an inventory of the City's fiscal policies and procedures (P&Ps) specific to the finance and accounting areas, a gap analysis to identify what gaps in coverage exist, and prepared a prioritized work plan to aid the City in addressing the identified gaps.

Beyond the identification of potential gaps in coverage, the gap analysis included an assessment of opportunities to improve the overall content and flow/structure to provide effective resources for employees. As reflected in the results and work plan, Moss Adams categorized the significance and extent of the identified gaps as follows: full gaps, major gaps, or minor gaps. An associated risk level and recommended priority level was

assigned to each of the identified gaps. In addition, areas that only require an update were noted as such. The categories ranked high or moderate risk include:

- High Risk:
 - Inventory
 - Procurement
 - Revenue and Accounts Receivable
- Moderate Risk:
 - Accounts Payable
 - Cash Management
 - Contract Management
 - Debt Management
 - Fixed Assets Management
 - Grant Management

The remaining thirteen policy areas were rated as low risk. City staff concurs with the findings and recommendations from Moss Adams as outlined in Attachment B. It is important to note; however, that the City does have appropriate internal controls in place relative to the areas identified as high and moderate risk, which is validated by the clean audit opinions from the City's financial statement auditors in recent years relative to internal controls. Nevertheless, it is clear that additional documentation is needed, and in accordance with the recommendations City staff will work towards addressing all of the recommendations. This process will include creating a standard template and structure for all levels of P&P documents and implementing the prioritized work plan over the next few years. Updates relating to City Council policies will be presented to the Finance Committee for consideration, and subsequently to the City Council for approval, prior to implementation.

Inventory Management Internal Controls Testing

The City Manager's Office completed an internal audit of the City's centralized warehouse and auto parts inventory operations. This review included identifying strengths and weaknesses of the operations and making recommendations on how to maximize efficiencies with current resources. As part of the analysis, interviews were conducted with Finance Department staff responsible for the operations as well as relevant staff in various departments that participate in the processes under review. In addition, a variety of materials and data were utilized as part of this audit, including current inventory usage and accounting records for the prior three years, internal controls documentation, and operational procedures.

This internal audit yielded several recommendations on improvement opportunities that are outlined in Attachment C and relate to the following key areas: staffing, accounting, warehouse management, auto parts inventory management, fleet management, and Utilities Yard inventory management. Since completion of this audit, a work plan has been created to address each improvement opportunity, with many of the identified items either

already implemented or in the process of being implemented. The following improvements were identified for implementation:

- The Purchasing and Contracts Administrator position now provides more direct supervision of the central warehouse and auto parts inventory staff, with this position splitting time between City Hall and the City Warehouse.
- A full inventory of auto parts and reconciliation against the inventory management system has been conducted and staff in the Finance and Public Works departments are currently in the process of purging unused or infrequently used parts.
- Staffing at the City Warehouse has been evaluated to ensure that resources are best utilized and assigned.
- A review of the inventory in the City Warehouse is in process to evaluate which items it is appropriate to stock versus order on demand or have vendors order as part of service and maintenance contracts.
- Instructions, forms, and processes related to requests for proposals and bids were improved to streamline the procurement and contracting process.

As this report was the first to be completed, many of the recommendations have already been implemented. Staff anticipates completing implementation of the report's recommendations within the next six months.

Concurrent with the implementation of the identified improvement opportunities for these three internal control areas of focus, City staff will continue undertaking audit work for additional focus areas, with a report on the selection of topics for Fiscal Year 2021-22 included with today's agenda. The final two reports from the Fiscal Year 2020-21 internal audit program are anticipated to be presented to the Finance Committee in February.

Prepared and Submitted by:

/s/ Amber Haston

Amber Haston
Senior Budget Analyst

Attachments:

- A. Procurement Operational Review Final Summary Report
- B. Fiscal Policy Inventory and Implementation Plan Final Summary Report
- C. Inventory Management Internal Controls Testing Final Summary Report