



ORGANIZATION-WIDE RISK ASSESSMENT

Prepared By:

**Craig Hametner, CPA, CIA, CMA, CFE
City Auditor**

**Randall Mahaffey, CIA, CGAP
Senior Audit Analyst**

INTERNAL AUDIT DEPARTMENT

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CITY OF GARLAND

ORGANIZATION-WIDE RISK ASSESSMENT

#0806

OVERALL EVALUATION

To address the increased emphasis on risk management, the City of Garland should undertake a program to identify and analyze the risks associated with the various programs operated by the City and services provided to the citizens. After the risks are identified, their impact on the operations and the probability of their occurring can be quantified. Through the risk evaluation process, the City can prioritize its efforts to control the risks and allocate the resources necessary to protect the City's ability to continue providing programs and services for the citizens.

BACKGROUND

The Internal Audit Department, with the assistance of the University of Texas at Dallas Internal Audit Program Interns, has undertaken a program to identify the auditable units that will be analyzed in an organization-wide risk assessment. Management has elected to identify the units using the financial account balances from the September 30, 2006 Comprehensive Annual Financial Report. Due to limited resources, the analysis concentrated on the major governmental and proprietary funds identified in the financial statements.

Using the Balance Sheet and/or the Statement of Net Assets for each major fund, each asset and liability account was categorized according to the following level of materiality:

- | | |
|---------------------------------|-----------------------|
| 1. <= \$500,000 | 1 = low risk |
| 2. = \$500,000 - \$2,000,000 | 2. = low/medium risk |
| 3. = \$2,000,000 - \$5,000,000 | 3. = medium risk |
| 4. = \$5,000,000 - \$15,000,000 | 4. = medium/high risk |
| 5. >=\$15,000,000 | 5. = high risk |

All accounts that were identified as medium, medium/high, or high risk accounts were analyzed and risks associated with the type of activity were identified.

If during the course of an engagement, information comes to the attention of the auditor, Government Auditing Standards 6.13 b. requires the auditor to perform procedures to follow-up on indications that fraud, illegal acts, or violations of provisions of contracts may have occurred. We applied this principle in evaluating the units identified in the materiality tests. We want to be aware of the potential for fraud and abuse. Operational areas that would be considered in addition to the financial account balances in evaluating a unit could include the following:

- Flow of funds
- Operations complexity
- Transaction complexity
- Major operating system changes
- Significant changes in management
- Regulatory compliance issues
- The age of program
- Extent of oversight from the external auditors

SCOPE AND OBJECTIVES

For the purpose of financial reporting, each operating fund utilized by the City as well as the General Fund will be reported as a “major” fund if it meets criteria related to the fund assets, liabilities, revenues, and expenditures. The major funds are the most significant funds utilized by the City’s accounting system. The General, Capital Projects, Debt Service, Electric, Water, and Sewer Funds were included in the risk analysis.

The account balances for each major fund identified in the September 30, 2006 Comprehensive Annual Financial Report were included in the analysis.

The objectives of the risk assessment were:

- To perform a comprehensive assessment of management’s oversight role in assessing various types of risk, including the risk of fraud.
- To perform a periodic analysis of the financial, investment, legal, business continuity, and insurance risks areas.
- To identify the general risks associated with various operating accounts identified in the analysis of materiality levels.

METHODOLOGY

For each account/program with a materiality level of medium, medium/high, or high risk, we analyzed and identified the risk associated with each activity. The types of risk were classified into one of four general risk categories. The analysis was performed while considering the impact a risk can have on the organization and the probability that a risk will become a reality.

The four general risk categories were:

1. People
2. Process
3. System
4. External party/event

The “impact” is the effect a single occurrence of that risk will have upon the achievement of the City’s goals and objectives.

1. High impact – “show stopper” – the effect will cause the City not to achieve its goals and objectives.
2. Medium – the effect will cause the City to operate inefficiently and/or expend unplanned resources to meet goals and objectives.
3. Low- no measurable effect upon the achievement of the City’s goals and objectives.

The “probability” that a risk will become a reality at the City. Probability is impacted by the internal control and risk management processes that management has implemented to mitigate the probability of an occurrence. Strengths and weaknesses have a direct relationship to increases and/or decreases in probability.

1. High – the risk will become a reality frequently at the City.
2. Medium – the risk will become a reality infrequently at the City.
3. Low – the risk will rarely become a reality at the City.

RECOMMENDED IMPLEMENTATION

This project was designed with the intent of implementing the processes in stages. Internal Audit undertook the initial phase of identifying the auditable units using the materiality levels found in the financial statements. After the major components were identified, we examined the potential risks associated with the type of activity. These risks were generic in nature and commonly found in most entities. The risks are there because of the characteristics of the operations and not specific to the entity.

While evaluating the potential risks, we considered the possibility of fraud, waste, and abuse in the operation. We wanted to consider the question of “what can go wrong and the impact”. To address the fraud question, we developed the *Inquiries of Management Concerning Fraud* checklist. It was designed for discussions with senior management to obtain their understanding of fraud, disclose the programs the managers have implemented to mitigate the potential for fraud, and allow them to discuss the existence in their organization.

We recommend that the Managing Director of Financial Services be responsible for developing the procedures for inquiring of management concerning the potential for fraud in their organization. The inquiries could begin with the programs identified in the *Risk Assessment Matrix* as “High/Low (H/L)”, “High/Medium (H/M)”, and “High/High (H/H)”. We are recommending these programs because the availability of resources to perform the interviews and document the findings. Use your resources for higher risk areas and move to the lower risk areas when time and resources become available.

The significant programs that we recommend to start with are:

- Financial statement preparation
- Cash
- Investments
- Ad Valorem tax revenue
- Utility billing and collection system operations
- Utility billing revenues
- Electric energy operations
- Capital asset recording systems
- Debt management operations

The second phase of the inquiry phase is to examine in detail the internal controls related to the specific program. Financial Services staff can conduct interviews and test of controls identified in their interviews.

Documentation of the processes can include the interviews, flowchart diagrams of the process flows, and/or computer generated audit trails.

We have made available to management a set of *Standard Audit Program Guides* for operational areas such as:

- The control environment
- Risk management
- Payroll
- System access control
- Contingency planning

The guides are to aid in evaluating the programs at a more detailed level than the general organizational risk assessment.

The report appendices include the following and are available upon request from the Internal Audit Department.

- Inquiries of Management Concerning Fraud
- Consolidated Risk Assessment Questionnaires
- Standard Audit Program Guides
- Financial Statement Materiality Rankings

RISK ASSESSMENT MATRIX

I M P A C T	(H/L) Accrued sales tax, Sales tax revenue, Salary Expense, Ad Valorem tax revenue	(H/M) CAFR, Cash, investments, Ad Valorem tax revenue, Utility billing receivables	(H/H) Utility billing, Energy trading
	(M/L) Due from telecom, Franchise fees, EMS deferred revenue liability	(M/M) EMS receivable, Investment income, Tax note payable, Utility inventories	(M/H)
	(L/L) Due from golf, EMS revenue, GISD reimbursement	(L/M) TMRS liability	(L/H)
PROBABILITY			

HIGH ← ————— → LOW

HIGH

MEDIUM

LOW

LOW ————— → HIGH