KPMG

City of Houston

Diagnostic Controls Review
Grant Management Process

Conducted by: **Sylvia R. Garcia**
City Controller

November 14, 2000

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

SUBJECT: Diagnostic Controls Review - Grant Management Process
            (Report No. 00-19)

Dear Mayor Brown:

In accordance with the City's contract with KPMG LLP (KPMG), KPMG has completed a diagnostic controls review of the City of Houston's grant management process related to the Advantage 2000 system.

The objective of the review was for KPMG to assist management in assessing and enhancing risk management through the use of the Advantage 2000 system. Their report, attached for your review, summarizes KPMG's understanding of the City's grants management process and its objectives and controls, the underlying causes relating to the identified risks/issues and their recommendations. Draft copies of the matters contained in the report were provided to Department officials. The views of the responsible Department officials as to action taken or being taken are appended to the report.

We appreciate the cooperation extended to the KPMG auditors by Department personnel during the course of the review.

Respectfully submitted,

Sylvia R. Garcia
City Controller

xc: City Council Members
       Albert Haines, Chief Administrative Officer
       Cheryl Dotson, Chief of Staff, Mayor's Office
       Sara Culbreth, Acting Director, Finance and Administration Department

October 31, 2000

Sylvia R. Garcia, City Controller
City of Houston:

KPMG LLP (KPMG) has completed a diagnostic control internal audit over the City of Houston's (the City's) grant management process considering the recent implementation of the Advantage 2000 system. The objective of this internal audit was to assist you in assessing and enhancing risk management through the use of the Advantage 2000 system by grant management.

Our procedures included:

▪ Interviews of system users that are involved on a daily basis with grant administration.

▪ Observations and verification of described controls.

▪ Review of issues noted during the City's fiscal year 1999 Single Audit.

▪ Understanding and analyzing the effectiveness of the reporting and monitoring functionality of Advantage 2000 system in the grant management process.

This report summarizes our understanding of the City's grants management process and its objectives and controls the underlying causes relating to the identified risks/issues and our recommendations.

Our procedures were completed on March 28, 2000 and these procedures have not been updated since that date. KPMG is pleased to have assisted the Office of the City Controller with this continuous improvement effort and appreciates the assistance and cooperation of the Internal Audit Division as well as many other City personnel.

KPMG is pleased to have assisted the City with this internal audit and is available to discuss the corrective action plans and any implementation alternatives or issues. Further we appreciate the cooperation of many City representatives throughout this internal audit.
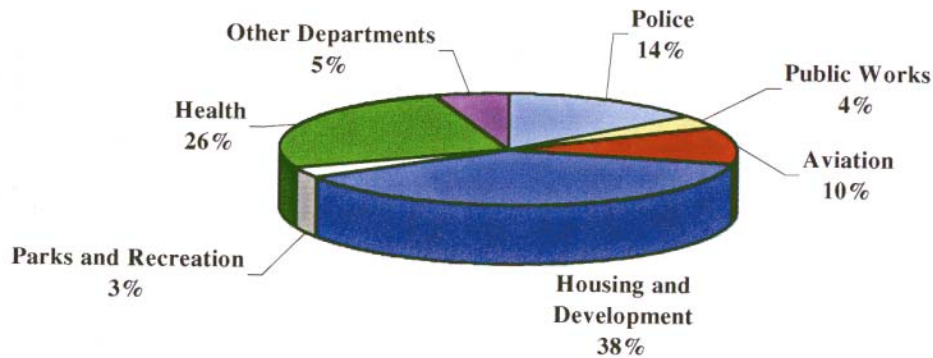
KPMG LLP

Executive Summary

During fiscal year 1999, the City received approximately $143,000,000 in Federal and State awards in the form of grants, contracts, loans, interlocal agreements, and memorandum of understandings. During 1999, the City's awards administered by department is depicted in the chart below:

Percentage of Awards Administered by Department

Based on the results of our audit procedures, we observed the following issues related to the City's grant management process:

- Current processes do not enable the departments to efficiently address all compliance requirements.

- Department driven processes focus solely on their respective grants, which creates inconsistent processing across departments and the development of spreadsheets/schedules outside of the Advantage 2000 system.

- Lack of user access to data and tools within the information system impairs the ability to efficiently monitor grant expenditures and prepare grant period based reports.

- System capabilities are not being fully utilized causing inefficiencies. However, the current system lacks needed functionality (such as tracking multiple funding sources for a single grant).

- There is a need for enhanced in-depth system training.

The issues noted above are fairly complex considering the number of departments involved and the wide range of grant programs managed. As such, these issues are presented in greater detail throughout this report along with discussion of our recommendations, of which the most significant are:

- Redesign the grant processes Citywide to both meet the department needs and enable compliance with various grant requirements. The redesigned processes should fully consider the features of Advantage 2000 so that the redesigned processes are supported by the system.

- Enable and train grant users to utilize existing system tools, such as the Decision Support Tool, currently owned by the City.

- Provide in-depth training on the system, the redesigned processes and available tools.

The challenges associated with meeting each department's needs with unique grant requirements while establishing a more uniform control structure over the grant administration and reporting process will require some investments in technology and training. As such, the issues and recommendations outlined in this report will require coordination and leadership. A preliminary outline for taking action is also included in this report to initiate a plan that enables improved controls, reduced administrative costs and maximized service to the citizens.

BACKGROUND

The City continues to be challenged with providing existing and/or increasing levels of services to its constituents while experiencing award cutbacks from higher levels of government and public pressures not to increase their significant revenue source, property tax. This challenge can only be limited by identifying new revenue sources and developing efficient and innovative service delivery. One such opportunity for the City to increase the levels of service to its constituents is to increase the efficiency of grant administration, which translates to less administrative expenditures to the programs and a corresponding increase in program services.

Service objectives that are currently being provided to the City's constituents through awards include:

➢ Feeding children through summer food programs,

➢ Developing viable urban communities by providing decent housing, a suitable living environment and expanding economic opportunities, principally for persons of low and moderate income,

➢ Improving the quality of existing emergency shelters for the homeless, providing additional emergency shelters and meeting the costs of operating emergency shelters and essential social services to homeless persons to improve their situations,

➢ Expanding the supply of decent and affordable housing for low and very low-income persons and extending partnerships among all levels of government and the private sector in the production and operation of affordable housing,

➢ Providing the resources and incentives to devise long-term strategies for meeting the housing needs of persons with acquired immunodeficiency syndrome or related diseases and their families,

➢ Providing certain economic development programs through Section 108 Loan Guarantee Assistance,

➢ Reducing crime and improving public safety,

➢ Providing additional services to increase the apprehension, prosecution, adjudication, detention and rehabilitation of persons who violate laws or are at-risk to violate laws,

➢ Assisting in the development of a nationwide system of airports through the planning, constructing, improving and repairing of the City's airports,

➢ Assisting in the construction and rehabilitation of the National Highway System,

➢ Providing a coordinated national highway safety program to reduce traffic accidents, deaths, injuries and property damage,

- Planning and developing an integrated interconnected transportation system, transportation improvements for certain roads and other special purposes, such as the bikeway project,

- Planning and carrying out water quality management,

- Promoting the use of integrated solid waste management systems to solve municipal solid waste generation and management problems,

- Training education professionals in the development and delivery of environmental education programs,

- Providing adult education and literacy services to assist adults in obtaining the knowledge and skills necessary for employment and self-sufficiency, to complete their secondary education and to obtain the educational skills necessary to become full partners in the educational development of their children,

- Providing supportive services and centers for seniors,

- Establishing and maintaining preventative health service programs through immunization and supplemental nutrition for women, infants, and children,

- Reducing morbidity and mortality by preventing cases and complications of sexually transmitted diseases, and

- Providing prenatal, preventive and primary child healthcare, family planning, genetic counseling and dental services for children and adolescents for Title V eligible clients.

The City is required to develop adequate policies and procedures through its grant management process, which should be supported by a financial system to help ensure the City efficiently and accurately account and report the awards in accordance with applicable requirements, including: the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, the State of Texas *Uniform Grant Management Standards*, and the *State of Texas Single Audit Circular*.

Compliance Monitoring Structure

The City's grant management process is primarily decentralized. Each department independently applies for an award, administers the award to meet the award objective(s) either directly or indirectly, while maintaining compliance with the following fourteen compliance requirements, as applicable:

- Activities allowed or unallowed
- Allowable costs/cost principles
- Cash management
- Davis Bacon Act
- Eligibility
- Equipment and real property management

- Matching, level of effort and earmarking
- Period of availability
- Procurement, suspension and debarment
- Program income
- Real property acquisition and relocation assistance
- Reporting
- Subrecipient monitoring
- Special tests and provisions

Failure to comply with any of these applicable compliance requirements could lead to the loss of assistance, resulting in the reduction of special services to the City's constituents.

Grant Management Process

The major stages of the City's grant management process are briefly described in the following paragraphs.

Approval/Acceptance

As of June 1997, City Council authorized department directors, or their designees, to apply for and receive funds under grant-assistance programs up to $400,000, provided the City is not required to provide a cash match as a condition of eligibility. For awards that do not meet the aforementioned criteria, at the application stage, a department submits grant documentation to the Finance and Administration Department (F&A), Grants Management Division (GMD) for pre-submission processing prior to being sent to City Council to approve the application and acceptance, if awarded.

Set-Up

When an award has been accepted by the City, the department administrating the award is required to set-up the award in the City's financial system. Information required for set-up includes fund number, appropriation code, award title, award number and specification of source as Federal (using the Catalog of Federal Domestic Award "CFDA" number), State or other, and approved budget. It currently takes from two weeks to two months for the set-up process to be completed, which is required before grant expenditures transactions can be processed.

Administration/Monitoring

Departments that administer numerous awards have developed their own respective procedures and controls to ensure compliance with the award objectives and requirements as well as managing the use of funds. Departments that administer few awards typically have not developed grant administrative procedures and controls related to the special tests and provisions. Depending on the type of award, grant operations may involve hiring of program personnel using the Citywide human resource process, training personnel, procuring goods and/or services

5

consistent with the award budget and the Citywide procurement process, constructing or acquiring fixed assets, monitoring subcontractors or subrecipients and delivering direct services.

Reporting/Audit Requirements

Each department is responsible for producing and submitting performance and/or financial reports as specified by the grantor — generally due monthly, quarterly and/or yearly. In addition, the City is required to have a Single Audit performed, since it has over $300,000 in award expenditures per year from the federal or state government. The Single Audit tests controls and compliance for the fourteen compliance requirements previously listed, must be submitted within nine months of the City's fiscal year-end and requires a Federal and a State Schedule of Expenditures. Additionally, many grantor agencies conduct periodic on-site monitoring of award compliance.

Process Analysis

Objective: All awards are identified and accurately set-up on a timely basis within the Advantage 2000 system.

Controls:

> ➢ Award applications are identified by F&A through the pre-application process.

> ➢ City Council approval is required to approve awards over $ 400,000.

> ➢ The procurement process requires identification of funding sources and City Council approval of purchases of $15,000 or more.

Issues/Risks:

> ➢ The pre-application process can be circumvented resulting in awards not being included in the Grants Summary Expenditures Report (GT17) and the risk that awards could be excluded from the Single Audit.

> ➢ Beginning effective award dates and related activities may have occurred prior to the award being set-up in the system. Such set-up delays have resulted in expenditures being posted and/or paid from the General Fund, increasing the risk of inefficiency in the use of personnel from the extra time consumed by reversing grant expenditures from the General Fund and posting them to the proper grant fund(s). This activity also increases the risk of incurring grant expenditures that are not properly or timely reimbursed as provided by the grant.

> ➢ The award set-up process is paper-intensive and cannot be tracked using the system. Thus, some departments maintain spreadsheets to keep track of awards through the set-up process.

Recommendations:

We recommend that the City consider requiring the signature of the Director of Finance for all awards accepted. This should allow F&A the opportunity to identify all awards accepted and to ensure their inclusion in the GT17.

Further, we recommend that the City use the capability of its system by redesigning the set-up process from paper-intensive to paperless. Not only should this reduce the time required for an award to be set-up in the system but it would also allow the departments to track the progress of their respective programs in the set-up process. The process redesign should consider the benefits of a preset-up process based on the grant application with start dates appropriately entered preventing any expenditures prior to the award being finalized and the beginning of the grant period.

Process Analysis

Objective: Reports such as the Federal and State Schedules of Expenditures are accurately generated by the system.

Control:

The system generates the GT17, which contains for each program certain required data and the expenditures for the fiscal year. The GT17 is used by the City to produce both the Federal and State Schedules of Expenditures (Schedules).

Issues/Risks:

➤ The GT17 requires considerable manipulation in order to produce the Schedules.

➤ There are no system edits to ensure funding source is indicated during the award set-up input.

➤ Source of funds can be a combination of federal, state and local. However, the set-up process does not address this issue and GT17 currently has only one source field.

➤ The GT17 does not include subrecipient data and this data is not easily obtainable in the system.

➤ The GT17 does not identify the required award agency pass-through data. Rather, the City uses the pass-through data from the prior year Schedules and contacts the respective departments as new awards appear on the GT17.

Recommendations:

We understand through discussions with management that the GT17 was designed as a grant management tool and was not initially intended to be used to produce the Schedules. As such, it does not contain all necessary information to produce the Schedules without significant additional research and manipulation. The City would benefit from the development of a system-generated solution that accurately produces the Schedules in an efficient manner. Management has represented that they are in the process of designing an improved reporting solution.

We further recommend that management identify all the information required in the reports/Schedules and modify its award set-up process to suspend grants with missing data. In addition, the system should have edit checks to ensure all required information has been entered in the system and should generate error reports for suspended grants or incomplete data fields.

Once developed, the new award set-up and reporting processes/capabilities should be documented and communicated to all personnel involved in the set-up and reporting for grant programs.

Process Analysis

Objective: Accurate reports are consistently prepared and submitted in a timely basis.

Controls:

> The Housing and Community Development Department (Housing) developed the Project Management Reporting System (PMRS), which was funded by the Department of Housing and Urban Development (HUD) for approximately $225,000 PMRS tracks housing projects pursuant to HUD's administrative and reporting requirements using grant data downloaded from Advantage 2000 directly into PMRS. Housing then reconciles the reports to ensure the integrity of the download, and accordingly is not experiencing most of the grant-related inefficiencies discussed in this report.

> Other departments use spreadsheets to facilitate performance and expenditures tracking consistent with the reporting requirements of their respective grant programs.

Issues/Risks:

> The Departments do not have adequate direct access to expenditure data and cannot produce reports directly from the system.

> At least one department who receives a hard copy of the Detailed Historical Grant Report (GT06I) manually inputs the data from the GT06I into spreadsheets as support for their required reports, increasing the risk of errors.

> One department updates its spreadsheets for tracking and reporting requirements by manually reprocessing data directly from expenditure documents. Payroll related expenditures are updated on a bi-weekly basis, by printing screens from the payroll system for each respective program personnel and manually entering the data into their spreadsheets. This process increases the risk of errors and causes inefficiency.

> Personnel time consumed by supplementary systems to produce required reports increases the grants administrative costs thereby reducing funds available for program services.

> Reconciliations are not always performed between the general ledger and the supplementary systems increasing the risk of inaccurate reporting and/or inconsistencies between the City's financial reporting and the award reporting.

Recommendations:

We recommend grant administrators' access privileges be expanded to enable them to access, sort and download all necessary data. In addition, these users should be provided access and training to certain system tools including the Decision Support Tool, a report writer purchased with the Advantage 2000 update, and Sybase. Initially, these tools could be provided on a pilot basis with the appropriate training necessary to use it to allow the grant administrators access to their data in order to understand what tools are most efficient for the administration of its grants without impairing system responsiveness.

9

Process Analysis

Objective: System generated grant data agrees to the general ledger.

Controls:

> ➢ Each grant is assigned a unique reporting category, which is required on all grant expenditure transactions.

> ➢ The grant ledgers have been programmed to pick-up all expenditures with reporting categories.

Issues/Risks:

> ➢ The system will accept grant expenditures missing reporting categories. At fiscal year-end 1999, there was approximately $1.2 million in reconciling items between the GT17 and the general ledger due to the lack of reporting categories.

> ➢ Awards administered in the General Fund or other non-grant fund do not use reporting categories and accordingly are not included in the GT17. Since such grants must be identified through a manual reconciliation, there is the risk that an award may not be included in the Single Audit.

> ➢ Expenditures for awards accounted for within the General Fund are commingled with other expenditures and cannot be readily identified as grant expenditures. The award revenue received is identifiable; however, required reporting is driven by the expenditures incurred and not by the amount advanced or reimbursed.

Recommendations:

We recommend that the system be programmed to only accept transactions for grant fund numbers that have reporting categories. This should ensure that the grant ledgers agree to the general ledger and eliminate some of the reconciliations that are currently required due to grant transactions without reporting categories posting to the general ledger and not to the grant ledgers.

We recommend when possible that grants not be accounted for in the General Fund. For those exceptions when a grant is accounted for in the General Fund, the City should consider establishing a separate sub-fund or process whereby grant expenditures can be identified and included in the appropriate reports.

Process Analysis

Objective: Grant transactions occur within the grant period and are processed efficiently and timely.

Controls:

> The system does not allow award transactions to post to a grant beyond a grace period of 30 days after a grant year-end date.

> The system does not allow award transactions to post to a grant prior to the inception of the grant period.

Issues/Risks:

> The Advantage 2000 system is configured based on the City's fiscal year-end, although most grants have different reporting periods. This results in the delay of grant transactions when the City performs its year-end closing procedures.

> To mitigate the delay of grant transactions, transactions are sometimes recorded in other accounts during the City's year-end closing process, which requires manual corrections at a later time resulting in personnel time inefficiencies and the risk of errors.

> In order to process Purchase Order (PO) and encumbrance corrections to a grant that has closed, the department is required to complete and submit documents to the Controller's Office to extend the grant period-end date. Once the correction has occurred, the department repeats the process of document completion and submission to the Controller's Office for approval in order to reinstate the original grant period-end close date. While a closed grant is reopened to make corrections, there is the risk that additional transactions can be posted to the grant, which then also have to be corrected.

> For invoices received after a grant period-end date that cannot be be fully processed within the grant's grace period, the system automatically generates and pays penalty interest to the vendor as the system defaults to the grant period-end instead of the correct invoice receipt date. When this occurs, corrections must be made because not only is the interest incorrectly paid but grants are not allowed to pay penalty interest and as such those cost must be charged to the General Fund. The system has also been incorrectly generating penalty interest to City personnel reimbursements for travel, mileage and petty cash purchases that are submitted after the grant period-end date and not fully processed within the grant's grace period.

> To circumvent the situation of interest penalties being paid and requiring correction as described above, at least one department is automatically extending the grant period-end in order to process these types of transactions and prevent the system from automatically generating interest. This extension of the grant period-end requires the document completion and submission to the Controller's Office as described above to both extend and then reinstate the grant period-end date.

11

Process Analysis

Recommendations:

> ➢ Although, the grant process is basically decentralized and certain grant requirements are unique to a department's program, grant administration and reporting processes among the departments can still benefit from some consistency. The City should establish a task force consisting of personnel involved in the day-to-day administration of the awards to establish consistent, comprehensive processes based on best practices that address all the compliance requirements. This team should also include system administrators in order to ensure their understanding of the special needs required to support the administration of the grants and to help ensure that the desired system changes to support the established processes are achievable and actually occur.

> ➢ Consistent processes based on best practices should increase efficiency, decrease the cost of administering the programs, and result in more program services being provided to the City's constituents. Additionally, consistent use of processes will strengthen controls, create a deeper Citywide grant knowledge base, and develop a Citywide grant career path as the processes cross department lines.

> ➢ We recommend that the City assess whether a separate grant application is needed or whether procedures can be developed to minimize the risk and the inefficiencies caused by processing delays and the problems that are currently being caused due to the system defaulting to the grant period-end date for transactions processed but not completed within the grant period-end grace period.

> ➢ Additionally, the system needs to be reprogrammed to correct the payment of penalty interest based on the grant period-end data rather than the date received for the vendor invoice or employee reimbursement request.

> ➢ The City needs to streamline the use of hard-copy documents in its processes by using the capability of the system. There are many instances of grant processes that are document intensive that would be much more efficient if processed through the system. For instance, the current process of extending the grant period-end date for corrections. If this process could be done through the system, not only would it be more efficient but it would shorten the window of opportunity for other transactions to post and have to be corrected.

12

Process Analysis

Objective: System supported process to manage data and monitor other grant-specific compliance requirements.

Controls:

- ➤ Housing's Project Management Reporting System has been tailored to assist the department in gathering and tracking data with regard to several grant-specific requirements, including: subreceipient monitoring, Davis Bacon Act applicability, environmental inspections, etc.

- ➤ Other departments use spreadsheets, manual files, etc. to gather the data and monitor other grant-specific compliance requirements including participant eligibility, service-level performance, program income, etc.

- ➤ Many department personnel involved in the administration of grants have been serving in their current positions for several years resulting in personnel who have received formal training, learned from various auditing and monitoring visits, and gained an understanding of the grant requirements and the department's supporting processes.

Issues/Risks:

- ➤ Due to the wide range of grant programs within the City and the fact that each program has specific compliance requirements and various performance-based reporting requirements, the departments have established unique reporting and monitoring processes resulting in a significant learning curve and risk of non-compliance in the event of personnel turn-over.

- ➤ Due to the manual nature of tracking compliance with various requirements and supporting the performance reported, there are risks of errors, and non-compliance with certain requirements.

- ➤ Grant reporting and compliance requirements continue to increase in complexity.

Recommendations:

To leverage off of the benefits realized by Housing, which include increased control over the performance and compliance aspects of grant administration, the City should consider evaluating the degree of customization and rewriting that would be necessary to establish a similar system for the health and human services grants. These grants are recommended due to the diversity of the grants and the fact that such grants comprise the next largest pool of grant revenues.

Once the needs are fully outlined, the cost of the system design and integration with other health systems should be determined to assess the cost vs. benefit of actually programming such a grant management system.

Other Opportunities for Improvement

KPMG has been informed that the City is currently investigating the Advantage 2000 Grant Module. In addition to having vendor presentations to grant administrators, we recommend that the City identify other entities that are currently using the module to receive first-hand information relating to the strengths and weaknesses of the grant module. During the performance of this internal audit, we made inquiries of several large municipalities to identify current Advantage 2000 Grant Module users and were unable to identify any.

Evaluation of the grants module should include determining if it addresses the system related risks/issues that have been identified in this report. If the City does decide to purchase the grant module, the City would probably benefit from aligning itself with an entity that has successfully implemented the module, including the possible exchange of any modifications that the entity has already developed.

Taking Action

Due to the uniqueness of many grant programs and the decentralized structure of the grants administration process, recommendations cannot be implemented in a "one size fits all" approach. As such, the following initial action steps outline some pilot projects to initiate improvement efforts and provide the research and trial information to support continuous improvement efforts throughout the process. As such, once these initial steps are taken and evaluated a long-term action plan should be developed.

Next Six Months

➤ Establish a pilot team to receive access to the Decision Support Tool report writer and provide the training and support necessary to download, sort and report transactions to generate the necessary grant reports. During this pilot project, methods for eliminating the use and generation of spreadsheets should be identified and standard system generated reports should be identified. This pilot may also identify needed program modifications to more effectively track and manage grants through the system.

➤ Establish a pilot team to receive access to the Sybase report database and provide the training and support necessary to download, sort and report transactions to generate the necessary grant reports. During this pilot project, methods for eliminating the use and generation of spreadsheets should be identified and standard system generated reports should be identified. This pilot may also identify needed program modifications to more effectively track and manage grants through the system and Sybase.

➤ Review the grant set-up process and identify all data currently not required in the system. From this analysis, programming personnel should review the data needs and determine whether the system could be enhanced to maintain such data.

➤ Identify current edit reports that should be generated from the system to minimize the risks noted throughout this report.

➤ Have a cross-departmental team, supported by an independent facilitator, meet to outline issues in the award set-up process with the result being a redesigned process.

➤ Research the Advantage 2000 Grant Module for its effectiveness of features to resolve the issues outlined herein, user friendliness, and cost.

➤ The Health and Human Services Department (Health) and Housing Department should meet and outline the needs for a system (similar to Housing's) that can assist with the tracking and monitoring of both financial and non-financial compliance and reporting requirements of Health's grants. Once the needs are outlined, information technology professionals should assess the degree and cost of modifying and rewriting the Housing system to meet the Health's needs.

15

Views of Responsible Officials

EXHIBIT 1

CITY OF HOUSTON

Department of Finance and Administration
Post Office Box 1562 Houston, Texas 77251-1562 713-837-9888

Lee P. Brown, Mayor

CITY COUNCIL MEMBERS: Bruce Tatro Carol M. Galloway Mark Goldberg Jew Don Boney, Jr. Rob Todd Mark A. Ellis Bert Keller Gabriel Vasquez
John E. Castillo Annise D. Parker Gordon Quan Orlando Sanchez Chris Bell Carroll G. Robinson CITY CONTROLLER: Sylvia R. Garcia

Sara S. Culbreth
Acting Director

May 8, 2000

Ms. Lisa D. Anderson
Partner
KPMG LLP
700 Louisiana
Houston, Texas 77002

Dear Ms. Anderson:

I have enclosed a copy of our response for your comments in the Diagnostic Controls Review Grant Management Process report. Your report will assist us in creating a citywide grants management system that will provide the financial, performance and compliance information necessary to manage the City's grant activities. If you have any questions regarding this response, please contact Mr. Les Manning (713) 837-9636 or Mr. Harold Jackson (713) 837-9647.

Sincerely,

Sara S Culbreth

Sara S. Culbreth, Acting Director
Finance and Administration

SSC:LM:tc

cc: Judy Gray Johnson, City Controller's Office

Views of Responsible Officials

EXHIBIT 1

**Response to the
Diagnostic Controls Review
Grants Management Process Report**
By KPMG
March 28, 2000

Previous studies have identified the need for a comprehensive grants acquisition strategy, long range grants planning, grants training for all personnel involved, and development of a citywide grants management system. In 1994, the city began reviewing it grant management processes and since then has developed:

- a grant approval process that requires a single council approval action,
- better coordination of grant applications,
- a blanket grant authorization, which came from a focus group of grant operating departments
- improvements to the financial system that includes using reporting categories and the creation of the federal aid inference table,
- grant roundtable workgroups for the discussion of common problems and
- greater awareness of grant activities by executive management

Grant Management Process

Page 5
Approval/Acceptance

Departments follow their own internal grant application evaluation and review processes before submitting the grant application. Departments seek Council approval to apply for and accept funds, expend funds and to accept any subsequent awards, a process that was identified in earlier studies and streamlined. Matching funds are identified if they are required. The Grants Management section in Finance and Administration reviews the grant related Request for Council Actions.

Set-up

The City Controller's Office will not accept grant set up documents unless fully executed grant award or contract documents are attached. Some of the delays in setting up grant documents are the results of acquiring the proper signatures on the approved documents.

Administration/Monitoring

Departments with few grants are less likely to have personnel that are familiar with the additional processes and procedures that grants require. We have also recently

Views of Responsible Officials

EXHIBIT 1

experienced personnel turnover in departments with large numbers of grants that have hindered the administration of the grant programs. Continuous formal training on processes and procedures is necessary.

Page 6
Reporting/Audit Requirements

Departments are responsible for submitting all performance, compliance and financial reports related to their grant activities. F&A and the Controller's Office coordinate single audit activities.

Process Analysis

Page 7
Objective: *All awards are identified and accurately set-up on a timely basis within the Advantage 2000 system.*

A process of formal notification of grant award other than the grant set up process is good. Delays in setting up grants into the system are sometimes caused by the time required to get fully executed (signed) documents. Requiring an additional signature may not expedite the process. City procedures have the grant set up documents approved by both F&A and the City Controllers before the documents are set up in the financial system. Circumventing this procedure would have the department use its regular operating funds to operating the grant program.

The grant set up process is paper intensive, particularly for large or major grant programs such as Community Development Block Grants or public health programs from the Texas Department of Health. Document identification numbers are used to track the documents, although the financial system cannot acknowledge what stage the approvals are. A paperless process from the current system is desirable if the notifications and approvals could be ironed out. We have seen demonstrations of the Advanced Grants Management module by AMS where grant set up documents for a grant program are automatically produced by the system from the grant application. This is a function that we would like to include in a citywide grants management system.

Page 8
Objective: *Reports such as the Federal and State schedules of Expenditures are accurately generated by the system.*

The current citywide grant expenditure report (GT17M) was designed to show fiscal year to date grant expenditures by grant appropriation. These expenditures are not categorized by source of funds or program activity, nor does it list subrecipient information. The recent changes to OMB Circular A-133 has made it crucial to identify federal and state sources of grant funds. There is definitely a need to generate a report that resembles the federal and state schedules of expenditures needed for the single audit.

Views of Responsible Officials

EXHIBIT 1

We will review the current grant set up process in addition to the Advanced Grants Management module to see if we can create a structure than could help generate those reports.

Page 9
Objective: *Accurate reports are consistently prepared and submitted in a timely basis.*

The current system does not generate reports that the departments can send directly to their granting agencies. The system generates reports for financial management of the grant program, but not reporting to a granting agency. We have had some success with PC based software (Rumba and Monarch) that allow us to download system generated grant expenditure reports directly into spreadsheets. This would eliminate the need to manually enter grant expenditure data. We recognize that at best, this is an intermediary step. Our preference is to have the system generate the financial reports needed to report to the granting agency. A step in that direction may be through the anticipated financial data warehouse, where customized queries of the financial information taken directly from the system could produce the needed expenditure reports. Also, preliminary reviews of the Advanced Grants Management module reveals that it has a standard financial report that could be use to report to a granting agency. This will have to be investigated further. We will have to train city personnel in using whatever system is created.

Reports for performance and compliance are not generated from the system. Advantage Financial 2000 does not include areas to accumulate this data. We will evaluate how Housing's Project Management Reporting System handles performance and compliance data and see if it can be used as a basis for a citywide grant management system.

Page 10
Objective: *System generated grant data agrees to the general ledger.*

The current system uses reporting categories to identify grant transactions. The recommendation that the system only accept transactions for grant fund numbers that have reporting categories appears to be sound. We will consult with departments with large numbers of grant transactions to see what affect it will have on their processing. The current system does generate reports (GTERR1 and GTERR2) that detail transactions that are in grant funds without reporting categories and transactions in non-grant funds with reporting categories. These reports are generated weekly and monthly for departments to review and detect errors in coding. It is possible to reconcile to the general ledger using these reports and the detail grant transactions report (GT06). These reports can be downloaded into spreadsheets. The current system also generates a monthly report that compares the grant ledger to the general ledger by grant.

The City has been moving grant programs out of the General Fund since 1992. The only reason a grant program would continue to be in the General Fund would be for cash flow purposes or for operational needs. The air quality program in the Health Department from the Texas Resource Conservation Commission is scheduled to be out of the General

Views of Responsible Officials

EXHIBIT 1

Fund in FY 2001. We will work with the Controller's Office and grant departments on developing a method of making grant expenditures in the general fund more visible.

Page 11
Objective: *Grant transactions occur within the grant period and are processed efficiently and timely.*

We are well aware of the current system's closed grant transaction processing challenges. Automated accruals and late payment penalties have created a no-win situation if you back date transactions to before the grant-end-date (generating late pay penalties) or if you extend the grant end date (allowing accruals and other items to process). We understand that the Advanced Grants Management module has a feature that not only allows warnings that a end-date is approaching but allows us to select what kind of transactions are acceptable in the warning period before a grant ends and in the post grant period. An example of this would be to accept only JV transactions in the post grant period. This appears to be a feature that we would like to include in a citywide grants management system.

We understand that the City is also evaluating the Travel Authorization module for Advantage Financial, and perhaps a solution to the interest penalties on travel reimbursements can be found there.

Page 13
Objective: *System supported process to manage data and monitor other grant-specific compliance requirements.*

The Housing & Community Developments Project Management Reporting System (PMRS) tracks housing projects in order to meet HUD's administrative and reporting requirements. This system does address some of the compliance and performance reporting issues as well as providing financial information in formats that can be both reported to HUD and used by department management to operate the grant. It is a very good system. However, to use it citywide would require some major modifications. This system was written specifically for HUD programs. It would have to be modified to meet the particular needs of other federal programs in the U.S. Department of Justice, the U.S. Department of Health & Human Services and the U.S. Department of Transportation, to name a few. Modifications would also be needed to accommodate the requirements for the Texas Criminal Justice Division, the Texas Department of Health, the Texas Department of Human Services, the Texas Department on Aging, the Texas Natural Resource Commission and the Texas Department of Transportation. Perhaps an approach would be to build several granting agency specific modules and tie them together into a citywide grants management system where single audit information can be obtained. We could start with the U.S. Department of Health & Human Services and the Texas Department of Health. The system would also have to be written in a programming language that would allow it to operate on the City's Wide Area Network.

Views of Responsible Officials

EXHIBIT 1

Page 14
Other Opportunities for Improvement

Our preliminary review of the Advanced Grants Management module for Advantage Financial reveals it has some features that would be beneficial to our management of grant programs. We also understand that to implement this module would completely change the way we account for grant transactions (no reporting categories and a change to the chart of accounts), and that the module does not address the performance and compliance reporting issues. The vendor has admitted to us that no large municipalities are using this system and that the module is a combination of previous grant management systems designed for states and universities. The development of the citywide grants management system probably lies somewhere between the PRMS system in Housing and the Advanced Grants Management module from AMS. AMS has expressed a willingness to suggest modifications to the current systems and well as possible bringing over some features from Advanced Grants Management module to help us build the citywide grants management system.

Taking Action

Some of the recommended actions have already begun to some extent. The Department of Health and Human Services and the Department of Housing and Community Development have met previously to discuss the merits of PRMS and possible modifications necessary to implement the system at Health. The Health department has also expressed strong interest in the Advanced Grants Management module from AMS that was demonstrated at the AMS User's Group Conference last year. In the last several months, the Controller's Office has met with Housing, Health, Public Works and Aviation on reports and queries for the financial data warehouse, which would provide financial information in a similar fashion as the Decision Support Tool and the Sybase report database produce.

A focus group from the Grants Roundtable was formed to review the approval/set up process and issue instructions to standardize the process. The installation of the Advantage Financial System has suspended the group's effort. The Controller's Office has resumed training classes on the federal aid module of Advantage Financial.

We should establish a cross-departmental taskforce that will resume the task of improving the approval/set up process and to take previous information that has been produced in reviewing grant management processes from along with the assessments from this audit to determine how a citywide grants management system can be developed and implemented.

Views of Responsible Officials