

City of Houston, Texas

Report to Management for the
Year Ended June 30, 2008

December 19, 2008

City of Houston, Texas
901 Bagby
Houston, TX 77002

In planning and performing our audit of the financial statements of City of Houston, Texas (the "City") as of and for the year ended June 30, 2008 (on which we have issued our report dated December 19, 2008), in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting. However, in connection with our audit, we identified, and included in the attached Appendix, deficiencies related to the City's internal control over financial reporting as of June 30, 2008, that we wish to bring to your attention.

We have also issued a separate report to the City, and management, also dated December 19, 2008, which includes certain matters involving the Company's internal control over financial reporting that we consider to be a material weakness under standards established by the American Institute of Certified Public Accountants.

The definition of a deficiency is also set forth in the attached Appendix.

This report is intended solely for the information and use of the Mayor, Members of City Council, the City Controller, management, and others within the organization and is not intended to be, and should not be, used by anyone other than these specified parties.

Yours truly,

Deloitte & Touche LLP

SECTION I — CONTROL DEFICIENCIES

We identified, and have included below, control deficiencies involving the City's internal control over financial reporting as of June 30, 2008, that we wish to bring to your attention:

A. RECONCILIATION AND REVIEW OF BALANCE SHEET ACCOUNTS

The City does not regularly reconcile and review accounts receivable accounts. The lack of timely reconciliations and reviews led to the following: (1) adjustments in the classification of receivables (2) overstatement of receivables in certain funds and (3) understatement of receivables in a fund.

The allowance for doubtful accounts related to certain accounts receivables was determined based on old historical collection data that has been carried forward for several years. The City should establish policies and procedures for calculating the allowances based upon historical experience taking into consideration collections in recent years.

The City does not perform a consistent reconciliation and review procedures related to all liability accounts. The lack of reconciliation and review led to the understatement of accounts payable and deferred revenue in a number of funds.

The City does not review balance sheet accounts for stale balances. The City should perform a detailed review and analysis of accounts with stale balances that have not changed between years.

B. WORKING TRIAL BALANCES

The City prepares its working trial balances based on the period 12 close. A significant number of adjustments were still required to be posted to the working trial balances after the close. The City should review its year-end closing process and evaluate the adjustments posted after the period 12 close to determine the cause of such adjustments and if such adjustments can be processed prior to the period 12 close. In addition, the City should ensure that the working trial balances are closed in a more timely manner.

C. SCHEDULE OF FEDERAL AND STATE GRANT AWARDS

The City did not adequately identify certain grants that it received for proper reporting purposes in the Schedule of Expenditures of Federal and State Awards. Particular attention should be paid to construction type projects that include a grant component to the overall funding formula.

D. FIXED ASSETS

The City improved upon the understanding and usage of the fixed asset system and subledger during fiscal year 2008. Although the City performs reconciliations and reviews annually, these reconciliations and reviews should be performed more frequently. The lack of frequent reconciliations and reviews caused a delay in timely and accurate fixed asset rollforwards, as well as multiple material revisions of such rollforwards during the audit.

E. AMBULANCE RECEIVABLE BALANCES

The City does not reconcile ambulance receivables to a detailed listing provided by the City's outside third-party service provider. Without proper monitoring of receivable balances, it is difficult to monitor the effectiveness of the third-party administrator.

F. RELATED-PARTY TRANSACTIONS

The City requires certain employee's to complete a conflict of interest statement; however, it does not appear that the City is tracking such related-party transactions for disclosure in the City's annual financial report.

G. REQUIRED RESERVES RELATED TO HOUSTON AREA WATER CORPORATION (HAWC)

In accordance with the amended contract between the City and the Coastal Water Authority, HAWC is to maintain an operating reserve in the project fund equal to three months average maintenance and operation expenses on the project as estimated in the annual budget. HAWC did not maintain the required amounts in reserve, as required by the contract, which resulted in an audit adjustment.

H. STREET PAVING LIENS

The City has not requested City Council approval to levy assessments in over ten years. The City has continued charging and collecting the assessment. The amount being collected is showing in a liability account and has accumulated to over \$1.6 million.

I. ESCHEATMENT OF OLD BALANCES

The City had old outstanding balances in deceased employee liability accounts General Fund from prior years. The City was in the process in fiscal year 2007 and 2008 to determine the amounts to escheat. However, the escheatment will not happen until fiscal year 2009. These balances relate to instances where City employees pass away and the City owes their estate for payroll, benefits, etc. Once the payroll items are greater than one year and an attempt to pay has been made, the amount is to be escheated to the State of Texas.

J. OPERATING LEASE SCHEDULE

The City prepares a schedule related to minimum lease payments for various operating leases for financial reporting purposes that originally included instances of incorrect lease terms and amounts of future lease payments. The City should increase efforts in this area to ensure an accurate and complete lease listing.

SECTION II — DEFINITION

The definition of a deficiency that is established in AU 325, *Communicating Internal Control Related Matters Identified in an Audit*, is as follows:

A *deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when (a) a properly designed control does not operate as designed, or (b) the person performing the control does not possess the necessary authority or competence to perform the control effectively.

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