

To Management of the City of Houston, Texas:

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Houston, Texas (the "City") for the year ended June 30, 2015, (on which we have issued our report dated December 2, 2015, which contains a reference to other auditors) in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, 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.

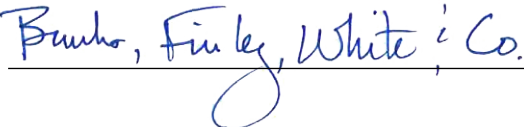
Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, in connection with our audit, we identified, and included in the following pages of this report, deficiencies related to the City's internal control over financial reporting as of June 30, 2015, that we wish to bring to your attention.

We have also issued a separate report to City Council and management, also dated December 2, 2015, which includes certain matters involving the City's internal control over financial reporting that we consider to be significant deficiencies under standards established by the American Institute of Certified Public Accountants.

A *deficiency* in internal control 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 *material weakness* is a deficiency or combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

This report is intended solely for the information and use of the City's elected officials, management and others within the City and is not to be and should not be used by anyone other than these specified parties. We will be pleased to discuss these comments with you and, if desired, to assist you in implementing any of the suggestions.





December 2, 2015
Houston, Texas

OTHER COMMENTS AND OBSERVATIONS

1. Analysis of General Ledger Accounts

In connection with our analysis of balance sheet accounts, primarily in the area of accounts receivables, and as noted in the prior year's audit, there are numerous accounts in the City's general ledger where there was either no change or minimal change from the prior year's balances. Further inquiry regarding these accounts as part of our audit in these areas revealed that many of these accounts were carryover balances that had been in place prior to conversion to the current financial accounting system (SAP). Furthermore, it is our understanding that for some of these accounts that relate to old outstanding receivables remains in the City's accounting records because the State of Texas does not allow local governments to write-off receivable accounts.

Recommendation

We continue to recommend that the City make efforts to appropriately offset and eliminate old outstanding accounts against active SAP accounts where possible. For old receivable balances, while the State does not allow these balances to be written off, the City should re-evaluate the methodology of the allowance computation and adjust the allowance accounts to fully reflect the inability to collect of old outstanding accounts.

2. Financial Reporting Model

In developing its comprehensive annual financial report, the City currently uses an extensive combination of electronic spreadsheets combined with word processing software. This system has been in place for several years; however, the complexity of continued use of the current model creates reporting risks as changes occur in reporting standards.

Recommendation

We would encourage the City to evaluate the current model and consider alternatives that might include at a minimum a complete review of the current system using electronic spreadsheets with internal checks.

3. Review of Swap Reports

In compliance with the provisions of GASB Statement Number 53, the City is required to evaluate the hedge effectiveness of its swap liabilities as of the end of each reporting period using a method prescribed by the standard. The City contracted a third-party pricing service provider to perform the effectiveness testing at year-end and provide a report summarizing the requirements, methods used and result of the testing.

During our review of the City's effectiveness testing report performed on synthetic and forward interest rate swaps for June 30, 2015 year-end, the 2014 expected cash flows for both variable receipts and payments were not consistent with the prior year effectiveness testing report. The third-party pricing service provider confirmed there was an error in the forward rate model they used in calculating the expected cash flows hence a correction was made and a revised report was provided. However, the revised report did not include the correct calculation details and several pages were missing. Finally, a Correct and complete report was provided. During our conversations with the City representatives, we noted that the City did not perform any review both on the effectiveness testing report and on the Swap Fair Market Value Report although we did not note any error on the latter.

When valuation reports are not properly reviewed, management and third party users may rely on inaccurate information that would result in improper disclosures in financial reports and could impact financial decisions.

Recommendation

We recommend management institute procedures to review and verify inputs and have a total understanding of the methodologies used in effectiveness testing reports.

4. Reporting Component Unit Activity

The City currently reports on 40 component units in its comprehensive annual financial report. Reporting requirements under generally accepted accounting principles indicate that at a minimum a local government only has to report detail financial information for those component units determined to be major and the nonmajor component units can be reported on in the aggregate.

Recommendation

We would encourage the City to consider aggregate reporting of nonmajor component units. Should the City elect this approach, it should continue to receive and monitor the annual audited statements of the nonmajor component units and consider some limited disclosure in the CAFR that those component unit financial statements are on file with the City.

5. Review of Information Technology Services Area

In connection with the audit and our review of internal control related to financial reporting, we noted the following items in the Houston Information Technology Services Department (HITS) of the City:

- As noted last year, HITS does not have an enterprise level user access policy for users by role and position. We understand that HITS plans to develop an electronic interface between the Active Directory, which contains all user access information, and SAP role-based security. By interfacing these systems, the City would have an enterprise level user access policy. The project to develop an electronic interface between Active Directory and SAP role-based security was, however, postponed. Although the project was delayed, it is planned for fiscal year 2016. We recommend that the City continue to move forward with this approach.
- The Houston Airport System (HAS) IT does not have a formal process to regularly evaluate IT for risks and ensure that risks are appropriately addressed. We recommend that HAS formalizes the risk and SWOT analysis process. Risk should be identified, tracked, and addressed.

HAS IT does not have a backup and data retention policy/schedule, specifying how often backups are to be performed, how long they are to be retained, and where the backup media is to be stored. HAS IT should develop and define a backup and data retention policy and controls to ensure that data is retained accordingly.

HAS IT does not have a Disaster Recovery nor Business Continuity plan. These are needed for all system containing financial data.

Application data and file server recovery procedures are not tested at least annually to ensure data integrity and recovery.

- Utility Customer Service (UCS) IT is not governed by a management steering committee responsible for reviewing and approving IT plans and priorities.

UCS IT does not have a formal process to regularly evaluate IT for risks and ensure that risks are appropriately addressed. We recommend that UCS IT formalize the risk and SWOT analysis process. Risk should be identified, tracked, and addressed. UCS IT indicated that they will develop and implement by the end of the second quarter in fiscal year 2016 a procedure with applicable timelines which provide for the performance of risk management activity.

UCS IT does not currently have a Disaster Recover or Business Continuity Plan. UCS IT, however, is currently implementing a cloud-based solution where UCS IT systems and data will be on the new IPS infrastructure post Go Live. Disaster recovery and business continuity plans are built into the design of this system using Amazon cloud computing. We would encourage the implementation of this solution.