



Houston Independent School District Internal Audit Report: Nutrition Services Department

February 26, 2024



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TRANSMITTAL LETTER



February 26, 2024

The Audit Committee of
Houston Independent School District
4400 W 18th St.
Houston, Texas 77092

Pursuant to the approved internal audit plan for fiscal year ("FY") 2023-2024 for Houston Independent School District ("HISD"), we hereby submit the internal audit of the Nutrition Services Department ("NSD"). This internal audit focused on the NSD's inventory receiving, cash safeguarding, invoice processing, and fixed asset verification processes. We will present this report during the Audit Committee meeting scheduled for April 16, 2024.

Our report is organized into the following sections:

Executive Summary	This provides a high-level overview and summary of the observations noted in our internal audit of the Nutrition Services Department.
Background	This provides an overview of the function and relevant background information.
Objectives and Approach	The internal audit objectives are expanded upon in this section, as well as a review of the various phases of our approach.
Observations Matrix	This section includes a description of the observations noted during our internal audit and recommended actions, as well as Management's response, including the responsible party, and estimated completion date.
Appendices	This section provides additional information, including a visual depiction of the workflow of key processes.

We would like to thank the staff and all those involved in assisting our firm with this internal audit.

Respectfully Submitted,

RSM US LLP

Internal Audit



EXECUTIVE SUMMARY (CONTINUED)

Observation Summary

Provided below are the observation risk rating definitions for the detailed observations.

Observation Risk Rating Definitions	
Rating	Definition
Low	Observation presents a low risk (i.e., impact on financial statements, internal control environment, or business operations) to the organization for the topic reviewed and/or is of low importance to business success/achievement of goals. Action should be taken within 12 months (if related to external financial reporting, must mitigate financial risk within two months unless otherwise agreed upon).
Moderate	Observation presents a moderate risk (i.e., impact on financial statements, internal control environment, or business operations) to the organization for the topic reviewed and/or is of moderate importance to business success/achievement of goals. Action should be taken within nine months (if related to external financial reporting, must mitigate financial risk within two months).
High	Observation presents a high risk (i.e., impact on financial statements, internal control environment, or business operations) to the organization for the topic reviewed and/or is of high importance to business success/achievement of goals. Action should be taken immediately, but in no case should implementation exceed six months (if related to external financial reporting, must mitigate financial risk within two months).



EXECUTIVE SUMMARY (CONTINUED)

Observation Summary

Below is a summary of the observations identified during this internal audit. The observation matrix includes detailed observations.

Summary of Observations	
Observations	Rating
<p>1. Inventory Management: Hazardous Cleaning Supplies</p> <p>Condition: Improper storage of hazardous cleaning supplies was observed at one site, and there was a lack of clear separation from food storage/preparation areas, posing contamination risks.</p> <p>Recommendation: Consider re-emphasizing cleaning supply storage expectations and enhancing current required employee training on handling, storage, and use of hazardous cleaning supplies. This training should also be part of new employee onboarding orientation.</p>	High
<p>2. Inadequate Fixed Asset Verification</p> <p>Condition: Fixed asset verification was not conducted in FY 2023. 54 assets reviewed lacked sufficient documentation for accurate asset management.</p> <p>Recommendation: Consider assigning a dedicated NSD employee to manage and validate the accuracy of the fixed asset verification process, with results communicated to the Fixed Asset Department for action. The Fixed Assets Managers should conduct training for NSD Leadership on guidelines and procedures for effective fixed asset verification.</p>	High
<p>3. Inadequate Cash Safeguarding</p> <p>Condition: Unlocked safe boxes containing cash were found at two locations, indicating lapses in safeguarding cash.</p> <p>Recommendation: Consider reinforcing the importance of secure cash storage by updating and distributing specific guidelines on safe box access and locking procedures. Initiate training for Team Leads and staff to promote strict compliance with cash handling protocols.</p>	Moderate
<p>4. Inventory Management: Inconsistent Order Discrepancy Process</p> <p>Condition: Inadequate documentation and communication of discrepancies in received goods were observed at 5 of 8 sites.</p> <p>Recommendation: Consider training Team Leads on guidelines, procedures, and resources to reconcile invoices, orders, and receipts in Primero accurately. Develop a consistent process for documenting discrepancies and returns in the "Outside Vendor Discrepancy & Credit/Return Spreadsheet," especially when received items differ from the invoice.</p>	Low
<p>5. Inventory Management: Deviation from First-In-First-Out (FIFO) Procedures</p> <p>Condition: Deviation from the FIFO method due to freezer space constraints at one site.</p> <p>Recommendation: Consider offering training for Team Leads and kitchen staff on using the FIFO method for accurate inventory management and waste reduction, including procedures for handling exceptional inventory situations. Improve inventory monitoring to reduce duplications, optimize freezer space, and assess the need for extra deliveries at specific locations based on storage and business requirements.</p>	Low



EXECUTIVE SUMMARY (CONTINUED)
Observation Summary (Continued)

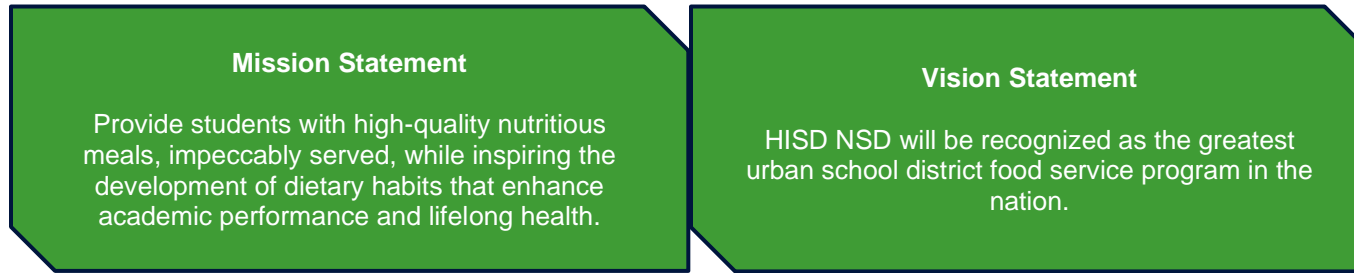
Summary of Observations	
Observations	Rating
<p>6. Inventory Management: Inconsistent Food Temperature Practices</p> <p>Condition: Inconsistencies in temperature verification of delivered frozen and refrigerated items were observed, risking food safety and compliance with procedural requirements.</p> <p>Recommendation: Train kitchen staff on proper storage practices to prevent the use of spoiled inventory and maintain food safety. Operations Coordinators should enforce food safety standards in their zones, including immediate temperature checks for frozen and refrigerated items before storage, to enhance food safety and optimize storage conditions for perishables.</p>	Low
<p>7. Bennington Warehouse Facility:</p> <p>Condition: The warehouse is underutilized with significant annual costs, presenting opportunities for improved utilization or alternative options.</p> <p>Recommendation: Considering conducting a cost-benefit analysis of the Bennington Warehouse to assess the economic impact of its current and potential uses, such as repurposing or selling the property and equipment. The results should inform strategic decisions to optimize resource allocation for NSD's goals and enhance District efficiency.</p>	Low



BACKGROUND

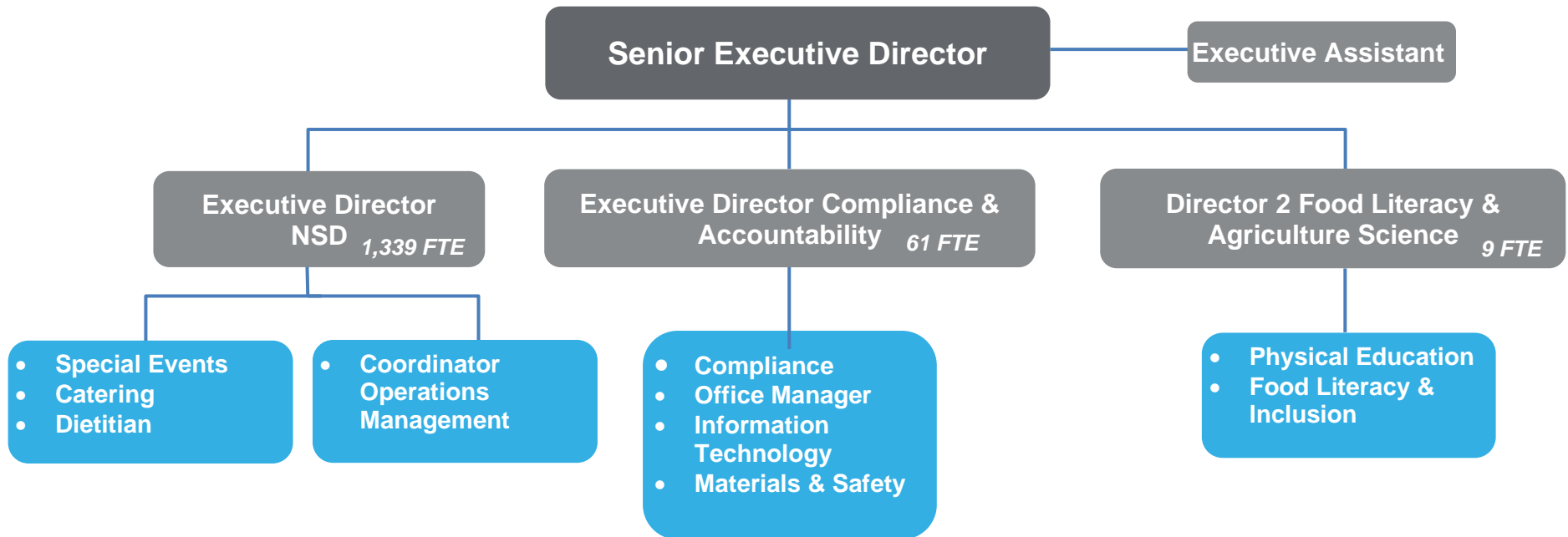
Overview

The Nutrition Services Department (“NSD”) provides school meal programs to ~274 school cafeterias and satellite locations within the District. The NSD’s primary functions include procuring food, meal planning, preparation, and distribution in accordance with federal and state nutritional standards. The NSD provides breakfast, lunch, snacks, and dinner services and serves over 193,000 meals daily¹.



Organizational Structure

The NSD employs approximately ~1,400 employees across four (4) subdivisions.



¹ Page 34 of the FY 2023 Adopted Budget Book



BACKGROUND (CONTINUED)

Financial Overview

The NSD's financial operations are grounded in federal and state program participation, including the School Breakfast Program and National School Lunch Program. These programs offer partial cost reimbursement for qualifying meals. The balance of meal service costs is managed through cash sales from a la carte items, staff and visitor meals, and state-matching funds. HISD schools benefit from the Community Eligibility Provision, which provides free meals to students. Additionally, the NSD participates in several other federal and state nutrition initiatives to enhance student access to nutritious foods.

Revenues

Total revenue has increased 9% from FY 2019 to FY 2023. The NSD's revenues are primarily derived from the United States Department of Agriculture ("USDA") through the National School Lunch Program. Over 80% of HISD students are eligible for free or reduced-price meals through this program. See *Figures 1 and 2* below for NSD revenue over the past five (5) years, according to the FY 2019 – 2023 Annual Comprehensive Financial Reports ("ACFR"), the FY 2024 Budgeted revenue, and the FY 2024 actuals as of January 31, 2024.

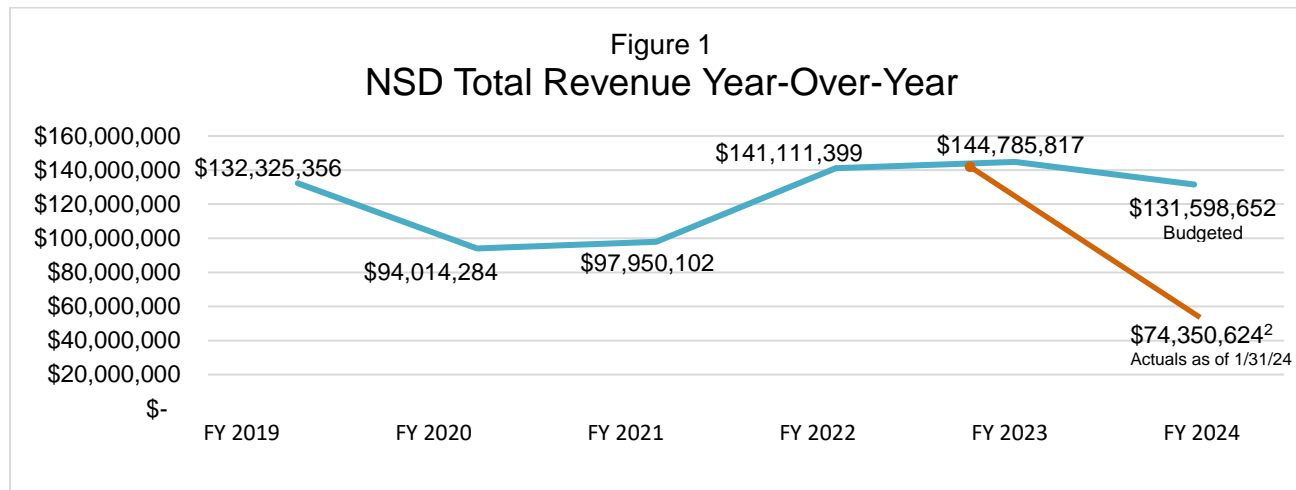


Figure 2 - NSD Revenues by GL Category		
Categories:	FY 2023	YTD FY 2024 ²
Food Sales	\$ 5,123,442	\$ 2,790,097
Nutrition Programs	\$126,827,637	\$ 63,853,599
Donated Commodities	\$ 9,080,550	\$ 5,601,763
Interest Income	\$ 3,167,822	\$ 2,101,892
Misc. Revenues	-	\$ 3,273
Grand Total:	\$144,785,817	\$74,350,624

² Actuals are from 7/21/2023 to 1/31/2024

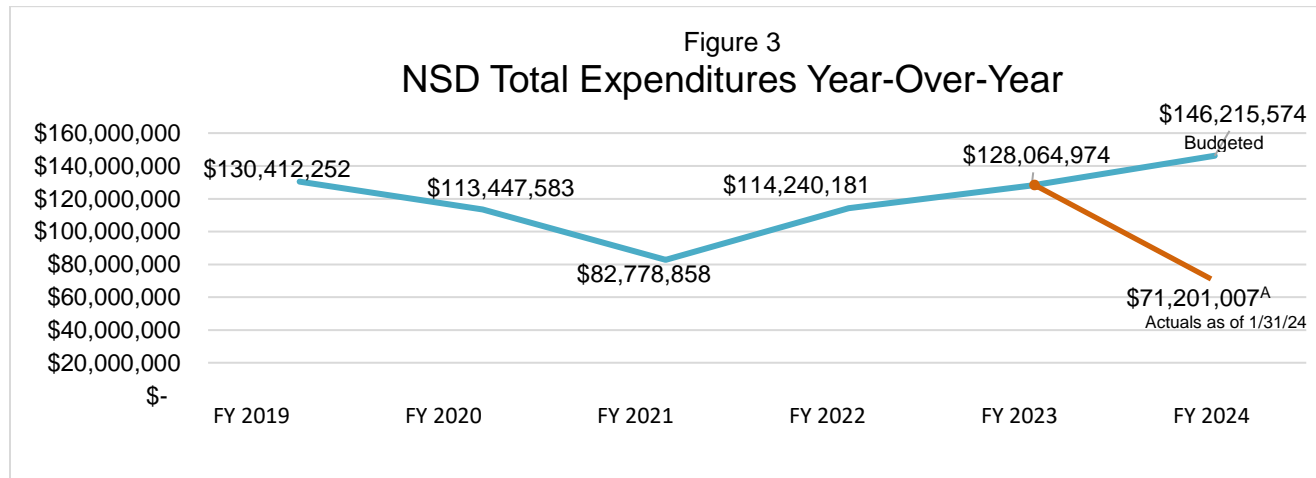


BACKGROUND (CONTINUED)

Financial Overview (continued)

Expenditures

As of FY 2023, total expenditures have decreased 2% since FY 2019. In FY 2023, NSD budgeted expenditures accounted for 3.77% of all budgeted expenditures throughout the District. See *Figure 3* below for NSD expenditures over the past five (5) years, according to the FY 2019 – 2023 ACFRs, the FY 2024 Budgeted expenditures, and the FY 2024 actuals as of January 31, 2024.



Please refer to *Figure 4* below for NSD expenditures by GL Category for FY 2023 and the actual Year-to-Date (YTD) for FY 2024 as reported by Nutrition Services Compliance & Accountability. Please refer to *Figure 5* below for the top 10 NSD vendor spending for FY 2023.

Figure 4 - NSD Expenditures by GL Category		
Categories:	FY 2023	FY 2024 ²
Supplies and Materials	\$ 71,709,856	\$ 47,945,996
Payroll Expenses	\$ 49,398,873	\$ 12,945,740
Other Operating Expenses and Indirect Costs	\$ 1,504,438	\$ 5,325,856
Professional and Contracted Services	\$ 4,804,031	\$ 3,837,638
Capital Outlay	\$ 375,518	\$ 1,145,777
Debt Service	\$ 272,257	-
Grand Total:	\$ 128,064,974	\$ 71,201,007

Figure 5 - Spend by Top 10 Vendors FY 2023	
Labatt Institutional Supply Company	\$ 41,001,273
Hardie's Fruit and Vegetables Co.	\$ 9,367,070
Dfa Dairy Brands Corporate, LLC	\$ 7,974,740
Kurz & Co.	\$ 1,859,239
Brandt Constructors & Facility Serv	\$ 584,431
Southwest Disposal, L.L.C.	\$ 399,890
Sysco USA I, Inc	\$ 371,122
Paleteria El Pibe, Inc.	\$ 322,683
United Refrigeration Inc.	\$ 283,673
Cybersoft Technologies Inc	\$ 272,257

² Actuals are from 7/21/2023 to 1/31/2024.



BACKGROUND (CONTINUED)

Operations

The NSD operates under regulatory guidelines set forth by the USDA and the Texas Department of Agriculture.

The NSD manages the largest school nutrition program in Texas and thus navigates multiple operational challenges. The NSD must coordinate meal services based on various school schedules, and staff turnover and labor force shortages are common within the NSD. NSD departments in all districts encounter food distribution supply chain challenges, including transportation delays, perishability issues, complexities in inventory management, fluctuations in demand, adherence to regulatory requirements, and the imperative of upholding stringent quality standards across the entire supply chain. Furthermore, the emergence of external food delivery services requires the NSD to position its meal programs to remain competitive strategically. Adapting to changing food trends and student dietary preferences is a continuous effort to maintain its meal offerings' nutritional quality and attractiveness.

To address these challenges, the NSD consulted a third-party firm specialized in warehousing and distribution services to conduct a cost-benefit analysis in May 2020. The analysis compared the NSD's expenses, including labor, utilities, and other costs, against the costs of a comparable school district. The analysis revealed that the NSD could reduce total costs by approximately \$2-4 million annually while avoiding anticipated capital expenditures of approximately \$5 million in the following 2-4 years for truck and refrigeration system replacements. Following the analysis, the NSD underwent structural changes, transitioning from a central warehouse to a decentralized model (the "Broadline Distribution model") managed by an external supplier, Labatt Institutional Supply Company, which commenced operations in July 2021. The Broadline Distribution model utilizes just-in-time inventory instead of centralized warehousing, enhancing flexibility. In this operational framework, individual schools are responsible for initiating orders and prompting the distributor to deliver the food and goods to each kitchen. The Nutrition Services personnel at the schools then prepare, cook, and serve the meals to the students. The objective of the Broadline Distribution model is to be cost-effective, promote consistent quality, and enhance risk mitigation. The supplier is responsible for food safety protocols, reducing the risk of foodborne illnesses and non-compliance with health and safety standards.

Policies and Procedures / Employee Training

NSD has established policies, procedures, and training programs to define and enforce compliance and operational efficiency across varying staff roles. These guidelines cover essential operational aspects, including uniform standards, safety protocols, and performance evaluations. New employees undergo a structured two-day orientation, with the first day dedicated to general employment practices and the second to specialized training in kitchen operations, such as safe food handling and adherence to state regulations. Regular and annual training sessions are conducted to facilitate professional development and compliance with national standards.

The Operations Coordinators, with the assistance of on-site Team Leads, oversees the training compliance. Standard Operating Procedures (SOPs) for goods receiving and inventory management are regularly reviewed and updated to align with best practices and regulatory requirements, supporting the department's commitment to operational excellence and safety in food handling. These SOPs are integral to NSD's efforts to promote health and safety, guiding the process for the receipt of food items in a manner that aligns with established guidelines.



BACKGROUND (CONTINUED)

Operations (Continued)

Inventory Receipt

The inventory receipt process is designed to adhere to the compliance standards and guidelines of the USDA and the Texas Department of Agriculture. Each school has a designated Food Services Attendant Team Lead ("Team Lead") that oversees this process. Receipting begins when the Team Lead receives a hard copy of the invoice and goods from the delivery driver. The process involves the following³:

1. **Quality Inspection:** The Team Lead conducts a thorough inspection to identify any visibly damaged goods and record the temperature of delivered items.
2. **Quantity Verification:** The Team Lead validates the delivered quantity matches the invoice details.
3. **Documentation:** The Team Lead and the delivery driver sign the invoice, with the delivery date noted on the inventory packaging.
4. **Storage:** The Team Lead and general kitchen staff utilize the First-in-First-out ("FIFO") method to store received goods, arranging inventory with older items positioned towards the back in freezers, refrigerators, and pantries.
5. **System Entry:** The Team Lead completes the goods receipt transaction in PrimeroEdge, verifying the receipt of ordered items against the order and documenting any discrepancies or substitutions.
6. **Discrepancy Reporting:** The Team Lead records any discrepancies in the shipment on the Discrepancy Form and forwards it to either the customer service department or the Operations Coordinator for a thorough review.
7. **Damage Reporting:** The Team Lead completes the documentation of shipment discrepancies on the Discrepancy Form and subsequently sends the form to the customer service department or Operations Coordinator for review.

Invoice Processing

Invoice processing is handled by a team of seven employees within the HISD Accounts Payable ("AP") department, who are assigned to support the NSD. The process involves the following³:

1. **Initial Data Capture:** Upon invoice receipt, Optical Character Recognition technology extracts key information such as quantity, unit price, vendor information, total price, purchase order number, and applicable taxes from the invoice, and the invoice details are systematically input into SAP.
2. **Invoice Matching:** The AP Analyst assesses the Vendor Invoice Management (VIM) Workplace inbox within SAP and matches the invoice with the corresponding purchase order ("POs") and goods receipt ("GR") in SAP to complete the three-way match.
3. **Discrepancy Resolution:** When there is a discrepancy between the invoice, GR, or PO, the AP Analyst contacts the applicable department or vendor through email to identify and address the root cause of the discrepancy. Upon successful resolution, the AP Analyst routes the invoice to batch processing within SAP.
4. **Non-PO Invoice Processing:** When an invoice without a corresponding PO is received, The AP Analyst routes the invoice and any other supporting documentation within SAP to the appropriate department for approval. Once the invoice is approved within SAP, the AP Analyst routes it to batch invoice processing within SAP.
5. **Service (No Goods Receipt) Invoice Processing for Concession Vendors:** When an invoice related to a service (no physical goods receipt) is received, the AP Analyst creates a shopping cart within SAP acting as a goods receipt for the transaction. Once the shopping cart is created, the AP Analyst routes the invoice to batch processing within SAP. The Concession Vendor is a vendor that has a preauthorized concession agreement with HISD.
6. **Batch Payment Approval:** Upon successfully matching the invoice with the GR or PO or obtaining the necessary approval, the invoices are consolidated into an invoice batch within SAP. Subsequently, the AP Manager authorizes the invoice batch for payment processing.

³ Reference *Appendix A* for detailed flowcharts related to Inventory Receipt



BACKGROUND (CONTINUED)

Operations (Continued)

Facility Maintenance

HISD has two (2) primary facilities maintenance teams: the District's Facility Maintenance Operations ("FMO") team, which is dedicated to general facilities maintenance for all HISD, and the NSD Facilities Maintenance team, which is solely responsible for NSD-owned equipment. The FMO promotes the optimal functioning, safety, and upkeep of the District's physical infrastructure, including buildings and equipment outside the school kitchens. Conversely, the dedicated NSD Facilities Maintenance team for the NSD focuses solely on equipment used for kitchen operations. Both departments share similar operations, conducting routine maintenance tasks, responding promptly to emergency repairs, managing assets, and maintaining accurate records of maintenance activities. The Team Lead from the schools contacts the facilities maintenance team dedicated to the NSD via phone to initiate a work order, which is documented and given a priority ranking by the Facilities Maintenance team. Simultaneously, the Team Lead records the work order in an internal log to track the completion timeline. Depending on priority, the facilities maintenance team performs the necessary work to satisfy the requirements outlined in the work order.

Fixed Asset Management

The Fixed Asset Department ("FAD") focuses on maintaining accurate records through an annual fixed asset verification process. Annually, the FAD generates the fixed asset ledger from SAP for all HISD departments and categorizes assets by SAP plant number. Once separated, the FAD distributes the fixed asset ledger to the respective department head. Specifically, for the NSD, the department head distributes the fixed asset ledger to the respective employees within the department to conduct verification procedures, including a detailed inspection of kitchen equipment, vehicles, and other tangible assets, validating their presence and that their condition matches the recorded details. The NSD employee conducting the count will note discrepancies between the fixed asset ledger and the fixed assets that were physically present. Inventory count results are provided to the FAD so that the master fixed asset ledger can be updated.



BACKGROUND (CONTINUED)

Operations (Continued)

Hexser T. Holliday Food Services Support Facility

The Hexser T. Holliday Food Services Support Facility ("Bennington Warehouse"), located at 6801 Bennington St, Houston, TX 77028, was previously central to the NSD in-house food production and operations. As of July 2021, it has been repurposed, as noted on page 8. Refer to *Observation #7 for additional details and RSM's recommendation*.

Key highlights related to the building include:

- 219,000 square-foot facility, located on 15 acres.
 - 198,000 square feet on the first floor, 21,000 square feet on the second floor, and a 33-bay dock.
 - Facilities within the warehouse include a production area, a refrigeration system, a cooler, office space, a training room, a computer lab, and substantial dry storage space.
- Currently, the warehouse serves multiple functions:
 - Upstairs and Downstairs: ~150 NSD administrative, maintenance, and operations employees utilize office space.
 - Downstairs: HISD IT Department stores IT equipment within the large walk-in refrigerated area.
 - Downstairs: NSD's catering business, Houston Eats, currently utilizes the kitchen and cooler to perform its operations. See page 12 for additional information.
 - Downstairs: Training room with a 150-person capacity is used for NSD staff on-boarding twice a month, as well as various other NSD and Business Operations conferences, trainings, etc.
 - Downstairs: Computer lab for NSD employees to complete compliance and other required training as needed.
 - Downstairs: Various NSD maintenance equipment is stored.
 - Parking Lot: NSD fleet of 140 vehicles for Operations Coordinators, QC, IT, FAL, Catering and Maintenance staff are stored.

Based on inquiry and on-site visit, the following capacity estimates were calculated related to the Bennington Warehouse:

- First Floor: 198,000 square feet with 80% vacancy. Therefore, 158,400 square feet are underutilized or unnecessary based on current usage.
- Second Floor: 21,000 square feet of office space with no vacancy; the staff fully utilizes NSD space.

The total Bennington Warehouse expenses for FY 2023 amounted to \$4,4348,980. The top nine expense categories for Bennington Warehouse in FY 2023 are shown in *Figure 6*.⁴

Figure 6			
Top 9 Bennington Expenses FY 2023			
Property Insurance	\$ 936,386	Xtr Pay/OT-Sup Sal	\$ 269,931
Electricity	\$ 408,673	Hourly Pay	\$ 226,473
General Supplies	\$ 371,268	Purch. Food-Charges	\$ 211,899
Misc. Contract Services	\$ 299,174	Contracted Maintenance	\$ 205,802
SBITA Principal	\$ 271,407		

⁴ Expense detail was provided by the Executive Director of Compliance & Accountability utilizing data from SAP for Fund 2400010000 for the following SAP Cost Centers: 1040830000, 104083100, 1040833000, 1040836000, 1040836000, 1040837000, 1040838000, 1050806060.



BACKGROUND (CONTINUED)

Operations (Continued)

NSD Catering – Houston Eats

Houston Eats, situated within the Bennington Warehouse, is the NSD's proprietary catering service initiated in 2004. Houston Eats provides meals for HISD meetings, dinner parties, conferences, and luncheons. Initially serving 250,000 meals monthly with a workforce comprising 23 drivers and 70 staff, the service has adapted to evolving District requirements and presently operates with an 18-member team with year-round service. Notably, the team adheres to predefined work schedules, with some overtime primarily incurred for late events. Additional fees for their services are collected for out-of-hours operations to provide structured management and financial sustainability within the catering line of business.

Reference *Figure 7* for details related to Houston Eats revenue and expenses for FY 2023. ⁵

Figure 7 Catering Revenue and Expenses FY 2023 ⁶		
Revenue Total		\$201,973
Expenses		
Purch. Food-Charges/Food Transfer Net	\$77,460	
Non-Food Supplies	\$44,014	
Xtr Pay/OT-Sup Salary	\$23,893	
Hourly Pay	\$14,450	
General Supplies	\$1,761	
Xtr Pay/OT-Supp Hourly	\$1,419	
Contracted Maintenance	\$200	
Expense Total		\$163,197
Total Profit		\$38,776

⁵ Catering Revenue and Expense detail was provided by the Executive Director of Compliance & Accountability utilizing data from SAP for Fund 2400010000 for the following SAP Cost Center 1040840000.

⁶ Immaterial differences in totals may be present due to rounding.



OBJECTIVES AND APPROACH

Objectives

The objective of this internal audit was to assess the design and operating effectiveness of controls within HISD NSD. This internal audit focused on the NSD's inventory receiving, cash safeguarding, invoice processing, and fixed asset verification processes to identify opportunities for improvement and enhance compliance with relevant laws and regulations, if applicable.

Approach

Our approach consisted of the following phases:

Understanding and Documentation of the Process

This phase consisted primarily of inquiry and walkthroughs to obtain an understanding of the current operating policies and procedures, monitoring functions, and control structures as they relate to the processes within our scope. The following was performed as part of this phase:

- Obtained and reviewed policies and procedures related to the in-scope areas and relevant information.
- Conducted interviews and walkthroughs with key personnel to obtain a detailed understanding of relevant operating policies and procedures, roles, and responsibilities within NSD.
- Gained an understanding of procedures related to the processes within scope.
- Developed a work plan to evaluate the operating effectiveness of procedures and controls based on the information obtained through interviews, walkthroughs, and preliminary documentation review.

Evaluation of the Process and Controls Design and Testing of Operating Effectiveness

The purpose of this phase was to evaluate the design of key processes and controls and test compliance and internal controls for operating effectiveness based on our understanding of the processes obtained during the first phase. We utilized sampling and other internal auditing techniques to meet our objectives outlined above. Our testing procedures included, but were not limited to:

- Performed site visits at 8 locations to assess inventory management procedures, verification of equipment condition, and cash safeguarding, including:
 - Verified the completion of a quality inspection for inventory receipt, validating proper rejection of damaged goods;
 - Confirmed the accuracy of inventory quantities against the ordered amount;
 - Confirmed proper documentation and monitoring of expiration dates for stocked inventory;
 - Verified the FIFO method for inventory storage, with newer items at the back and older ones at the front of the refrigerator unit;
 - Confirmed adherence to established protocols for documenting damaged goods, short shipments, and discrepancies;
 - Verified timely temperature readings and documentation (within Redbook) for frozen and refrigerated inventory upon receipt;
 - Assessed equipment conditions and prompt reporting of inoperable equipment to the relevant department for maintenance;
 - Inspected cash boxes and safes to confirm adherence to proper handling procedures for cash safeguarding.
- Assessed inventory procurement processes, including examining requisition procedures, delivery protocols, and compliance measures.
- Reviewed the organization's policies and procedures, including distribution and frequency of Board/Local Nutrition Services updates.
- Reviewed the FY2022 fixed asset verification procedures for NSD for completeness and accuracy. Verified the documentation and disposition of assets and validated the proper recording of proceeds from asset sales in the financial system.
- Evaluated the accuracy and completeness of three-way match processing (invoice, goods receipt, and order) to confirm validated invoices were processed for payment.
- Reviewed the due diligence efforts completed before outsourcing NSD functions.

Reporting

At the conclusion of this internal audit, we summarized our findings into this report. We have reviewed the results with the appropriate Management personnel and have incorporated Management's responses into this report.



OBSERVATIONS MATRIX

Observation	1. Inventory Management: Hazardous Cleaning Supplies															
High	<p>Per the 2023-2024 Hazardous Analysis Critical Control Point (“HACCP”) Plan and Standard Operating Procedures—300 Cleaning and Sanitizing, all hazardous cleaning supplies should be stored in a clear, designated area physically separated from areas where food is stored, prepared, or served.</p> <p>RSM conducted site visits at eight (8) locations to observe current inventory management procedures and compliance with procedural requirements. During our site visits, the following was identified:</p> <ul style="list-style-type: none">One (1) of the eight (8) sites visited did not properly store hazardous cleaning supplies in a clear, designated area physically separated from areas where food is stored, prepared, or served. We observed several bottles of bleach were stored on a shelf adjacent to packaged foods and produce in the pantry. <p>Inadequate storage of hazardous cleaning supplies may lead to unintended contamination or chemical reactions with food items and ingredients.</p>															
Recommendation	<p>HISD NSD should consider the following recommendation:</p> <ol style="list-style-type: none">The NSD should consider enhancing current required employee training on handling, storage, and use of hazardous cleaning supplies. This training should also be part of new employee onboarding orientation.															
Management Action Plan	<p>Response: Cleaning supplies were present on the bottom shelf in the storage area. Action was taken immediately when HISD was alerted to this situation at the school.</p> <table><tr><th colspan="2">Shelving Layout at time of Observation</th><th colspan="2">NEW Shelving Layout</th><th>New Rack</th></tr><tr><td>Paper Goods</td><td>Food</td><td>Paper Goods</td><td>Food</td><td>Cleaning Supplies</td></tr><tr><td>Cleaning Supplies</td><td>Food</td><td>Paper Goods</td><td>Food</td><td>Cleaning Supplies</td></tr></table> <p>Completed:</p> <ol style="list-style-type: none">QC inspection at this school conducted (part of the routine schedule) on January 25, 2024 - issue was still resolved.City of Houston Health Department Inspection on February 22, 2024 - this issue was still resolved. <p>Ongoing:</p> <ol style="list-style-type: none">Training for all Team Leads at L.E.A.D training.Monitored for compliance routinely with internal inspection , conducted by the HISD NS Quality Control Specialists.Monitored for compliance routinely with bi-annual City of Houston Health Inspections. <p>Additional Training: Scheduled to be conducted to all Team Leads April 16-18, 2024 during the monthly Team Lead meeting.</p> <p>Responsible Party: Nutrition Services Operations.</p> <p>Estimated Completion Date: Initial correction and follow up audits have been completed. This is an ongoing training topic for the department and Team Leads.</p>	Shelving Layout at time of Observation		NEW Shelving Layout		New Rack	Paper Goods	Food	Paper Goods	Food	Cleaning Supplies	Cleaning Supplies	Food	Paper Goods	Food	Cleaning Supplies
Shelving Layout at time of Observation		NEW Shelving Layout		New Rack												
Paper Goods	Food	Paper Goods	Food	Cleaning Supplies												
Cleaning Supplies	Food	Paper Goods	Food	Cleaning Supplies												



OBSERVATIONS MATRIX (CONTINUED)

Observation	2. Inadequate Fixed Asset Verification
<p>High</p>	<p>Asset verification is a process designed to confirm an organization's assets' existence, location, and condition. HISD standard procedures include the proper creation of the Fixed Asset Listing, physical inspection of the asset's existence onsite, documentation via photograph, tie-out to asset tag, identification of any discrepancies or missing assets, and communicating all findings to the Fixed Asset Department ("FAD") to update the status of the assets accurately. In cases where discrepancies are identified, ongoing communication with FAD should persist until the asset status is resolved.</p> <p>RSM inquired and identified that a Fixed Asset Verification was not conducted for FY 2023. According to Food Services Attendant Team Lead ("Team Lead"), staff limitations prevented the verification from being completed.</p> <p>The most recent fixed asset verification was performed in FY 2022. RSM acquired the documentation to substantiate that the fixed asset verification conducted complied with District policy and noted the following:</p> <ul style="list-style-type: none"> The NSD department did not designate an employee to manage the fixed asset verification process to validate its overall completeness and accuracy. Additionally, the NSD did not provide the results of the fixed asset verification to the FAD. 54 out of 131 fixed assets did not have sufficient supporting documentation to confirm the existence or identify the condition of the fixed asset: The total book value of the associated 54 assets amounted to \$32,299, compared to the overall book value of all 131 assets, which amounted to 40,358. <ul style="list-style-type: none"> 41 fixed assets lacked adequate photos to confirm their existence. 13 fixed assets did not include or had inconsistent serial or tag numbers. <p>The prompt submission of fixed asset verification results to the Fixed Asset Accounting Department facilitates timely and efficient asset management, including the sale, scrapping, or disposal of accurately identified assets. This practice promotes the integrity of asset records, supports compliance with financial and audit standards, and enhances the organization's decision-making and operational efficiency through accurate financial reporting.</p>
<p>Recommendation</p>	<p>HISD NSD should consider the following recommendation:</p> <ol style="list-style-type: none"> NSD should designate a dedicated employee within the department to manage the fixed asset verification process proactively. This selected individual should be responsible for ensuring the overall completeness and accuracy of the assessment. Upon validation, results should be communicated to the Fixed Asset Department, enabling action on assets to be sold, scrapped, or removed, thus streamlining asset management and reinforcing financial record integrity. The Fixed Assets Manager should conduct training sessions with NSD Leadership to establish explicit guidelines, procedures, and resource provisions for the effective execution of fixed asset verification procedures.
<p>Management Action Plan</p>	<p>Response: NS Department will take on this responsibility and partner with Fixed Asset Management.</p> <p>Responsible Party: Fixed Asset Management and NSD.</p> <p>Estimated Completion Date: NS Department will conduct the Fixed Asset Verification, schedule to be completed by end of FY 2024 and then annually moving forward</p>



OBSERVATIONS MATRIX (CONTINUED)

Observation	3. Insufficient Cash Safeguarding
Moderate	<p>Cash used during serving hours is limited to petty cash and is stored within safe boxes within Team Lead offices at each location. Access to the safe boxes is granted through codes issued to Team Leads, School Principals, and Operations Coordinators. At times, custodians and school principals have access to the keys to the kitchen area, where Team Lead offices are located, but they do not have access to the safe codes themselves. It is important to note that the amount of petty cash differs among schools based on the consumption volume at each location.</p> <p>RSM conducted site visits at eight (8) locations to observe current cash safeguarding procedures and validate compliance with HISD's requirements. During our site visits, the following was identified:</p> <ul style="list-style-type: none"> Two (2) of the eight (8) sites had unlocked safe boxes within the Team Lead's office that housed petty cash. <p>Ineffective safeguarding of safe boxes increases the risk of unauthorized access, potential theft, and misappropriation of funds.</p>
Recommendation	<p>HISD NSD should consider the following recommendations:</p> <ol style="list-style-type: none"> Reinforce the importance of secure cash storage by updating and distributing specific guidelines on safe box access and locking procedures. Initiate training for Team Leads and staff to promote strict compliance with cash handling protocols.
Management Action Plan	<p>Response: Safes are required to be locked when not in use.</p> <p>NS SOP and Training:</p> <ol style="list-style-type: none"> This is currently part of the NS Cash Handling Agreement. However, to improve compliance, the NS Cash Handling Agreement will be updated to provide more clarity on this standard. Training and reinforcing this SOP will occur April 16-18 during the Team Lead training. <p>Responsible Party: Nutrition Services Operations</p> <p>Estimated Completion Date: April 19, 2024</p>



OBSERVATIONS MATRIX (CONTINUED)

Observation	4. Inventory Management: Inconsistent Order Discrepancy Process
<p>Low</p>	<p>When receiving goods from outside vendors, the designated Team Lead verifies all received goods match the corresponding invoice and reconciles them with the total order amount. If a discrepancy arises between the invoice and the order, the Team Lead records the discrepancy using the Discrepancy Form. Subsequently, the form is archived, and an email containing the form is sent to the Operations Coordinators.</p> <p>RSM conducted site visits at eight (8) locations to observe current inventory receipting procedures and validate compliance with HISD's procedural requirements. During our site visits, the following was identified:</p> <ul style="list-style-type: none"> Five (5) of the eight (8) sites failed to accurately document identified order discrepancies on the Outside Vendor Discrepancy & Credit/Return form and provide these forms to the Operations Coordinators. At all sites visited, the Team Lead communicated the discrepancy through text, phone calls, or emails, but the required forms were neither completed nor forwarded to the Operations Coordinators. It is important to note that all discrepancies identified in this process were considered insignificant and would not cumulatively constitute a material difference, such as the absence of just one unit of a particular product. <p>Team Leads District-wide should have a standard and consistent process for inventory receipt and discrepancy procedures. The issues noted above indicate a need for enhanced training on correctly using documentation forms. When an order discrepancy is identified, the Team Lead should document all differences within PrimeroEdge (Primero), the District's cloud-based nutrition system, complete the Outside Vendor Discrepancy & Credit/Return Spreadsheet, and notify the Operation Coordinator via email.</p> <p>Inadequate documentation and communication of discrepancies highlight operational inefficiencies, which could lead to unrecouped funds due to overpayments or incorrect shipments, strained vendor relations, and inventory inaccuracies.</p>
<p>Recommendation</p>	<p>HISD NSD should consider the following recommendations:</p> <ol style="list-style-type: none"> Conduct training sessions with Team Leads to establish clear guidelines, procedures, and resources to accurately reconcile invoice amounts, total order amounts, and receipt amounts within Primero. Establish a consistent process for documenting the "Outside Vendor Discrepancy & Credit/Return Spreadsheet." A clear documentation protocol should be established for instances where items received do not align with the invoice.
<p>Management Action Plan</p>	<p>Response: The process for completing the Outside Vendor and Discrepancy & Credit/Return Form will have an established process.</p> <p>NS SOP and Training:</p> <ol style="list-style-type: none"> The process for completing the Outside Vendor and Discrepancy & Credit/Return Form will be using the online version. Operations Coordinators will assist the Team Leads if there are questions with the form. Training for all Team leads will also be provided. Training and reinforcing this SOP will occur April 16-18 during the Team Lead training. <p>Responsible Party: Nutrition Services Operations</p> <p>Estimated Completion Date: April 19, 2024</p>



OBSERVATIONS MATRIX (CONTINUED)

Observation	5. Inventory Management: Deviation from First-In-First-Out (FIFO) Procedures
Low	<p>Team Leads are tasked with verifying that incoming goods from external vendors match the corresponding invoice and order totals. Post-verification, kitchen staff must document critical information, such as SAP numbers, expiration dates, and delivery dates, on a copy of the signed invoice before employing the FIFO (First In, First Out) method for storage.</p> <p>RSM conducted site visits at eight (8) locations to observe current inventory management procedures and validate compliance with HISD's procedural requirements. During our site visits, the following was identified:</p> <ul style="list-style-type: none"> One (1) of the eight (8) sites had freezer space constraints, necessitating inventory reorganization. Instead of adhering to the FIFO methodology, items were arranged based on size or capacity. <p>Failure to follow FIFO inventory methods may increase the risk of inventory mismanagement, including inaccuracies and spoilage.</p>
Recommendation	<p>HISD NSD should consider the following recommendations:</p> <ol style="list-style-type: none"> Provide targeted training for Team Leads and kitchen staff on the importance of adhering to the FIFO method to validate inventory integrity and minimize waste. Procedures should also be designed for handling inventory management when non-routine matters occur, such as the event noted above. Enhance monitoring of inventory levels to minimize duplications and efficiently manage freezer space. If necessary, consider evaluating the need for additional deliveries for specific locations based on storage capacities and business needs.
Management Action Plan	<p>Response: The kitchen has been supported with reorganizing and sorting of the frozen items. An analysis has also been completed regarding frequency of deliveries.</p> <p>Ongoing Maintenance: Monitored for compliance routinely with internal inspections, conducted by the HISD NS Quality Control Specialists.</p> <p>Additional Training: FIFO training is scheduled to be conducted to all Team Leads during the one of monthly Team Lead meetings held throughout the year.</p> <p>Responsible Party: Nutrition Services Operations</p> <p>Estimated Completion Date: Initial correction and follow up inspections have been completed. This is an ongoing training topic for the department and Team Leads.</p>



OBSERVATIONS MATRIX (CONTINUED)

Observation	6. Inventory Management: Inconsistent Food Temperature Practices
<p>Low</p>	<p>Per the 2023-2024 HACCP Plan and Standard Operating Procedures, the Team Lead within each school is required to confirm the temperature of frozen or refrigerated food within the “Redbook.” Redbook is a food safety training program that covers critical topics such as hazard analysis, allergens, sanitation, and food handling practices and is a primary tool for complying with regulatory requirements. Redbook receiving requirements state frozen products should be at 32 degrees Fahrenheit or below, and refrigerated products should be at 41 degrees Fahrenheit or below.</p> <p>RSM conducted site visits at eight (8) locations to observe current inventory receipting procedures and to validate accordance with HISD’s procedural requirements. During our site visits, the following was identified:</p> <ul style="list-style-type: none"> One (1) of the eight (8) sites visited measured the temperature of the inventory after the items were stored in the freezer for approximately ten minutes instead of obtaining the temperature of the goods upon delivery from the vendor, which raises the likelihood of the temperature check proving ineffective, as the product may undergo temperature fluctuations between the time of delivery and the actual probing of the item. <p>Timely receipt and accurate temperature monitoring of frozen goods are crucial for food safety. They prevent the growth of microorganisms and reduce the risk of foodborne illnesses. By maintaining these practices, the organization actively supports regulatory compliance, preserves food quality, and safeguards consumer health and satisfaction, minimizing legal and financial risks.</p>
<p>Recommendation</p>	<p>HISD NSD should consider the following recommendations:</p> <ol style="list-style-type: none"> Provide training to kitchen staff to reinforce the importance of adhering to proper storage practices and preventing the use of spoiled inventory. The Operations Coordinator responsible for specific zones within the District should enforce and oversee adherence to food safety standards, including immediately measuring temperatures for frozen and refrigerated products before storage. This will not only improve food safety but also optimize the storage conditions of perishable items.
<p>Management Action Plan</p>	<p>Response: Receiving the deliveries and putting cold food away quickly is critical for food safety. Taking the temperatures at the time of delivery will be reinforced to the kitchen staff.</p> <p>Ongoing Maintenance: Monitored for compliance routinely with internal inspections, conducted by the HISD NS Quality Control Specialists.</p> <p>Additional Training: Training and reinforcing this SOP occurred March 19-21 during the Team Lead training.</p> <p>Responsible Party: Nutrition Services Operations</p> <p>Estimated Completion Date: Initial correction and follow up audits have been completed. This is an ongoing training topic for the department and Team Leads.</p>

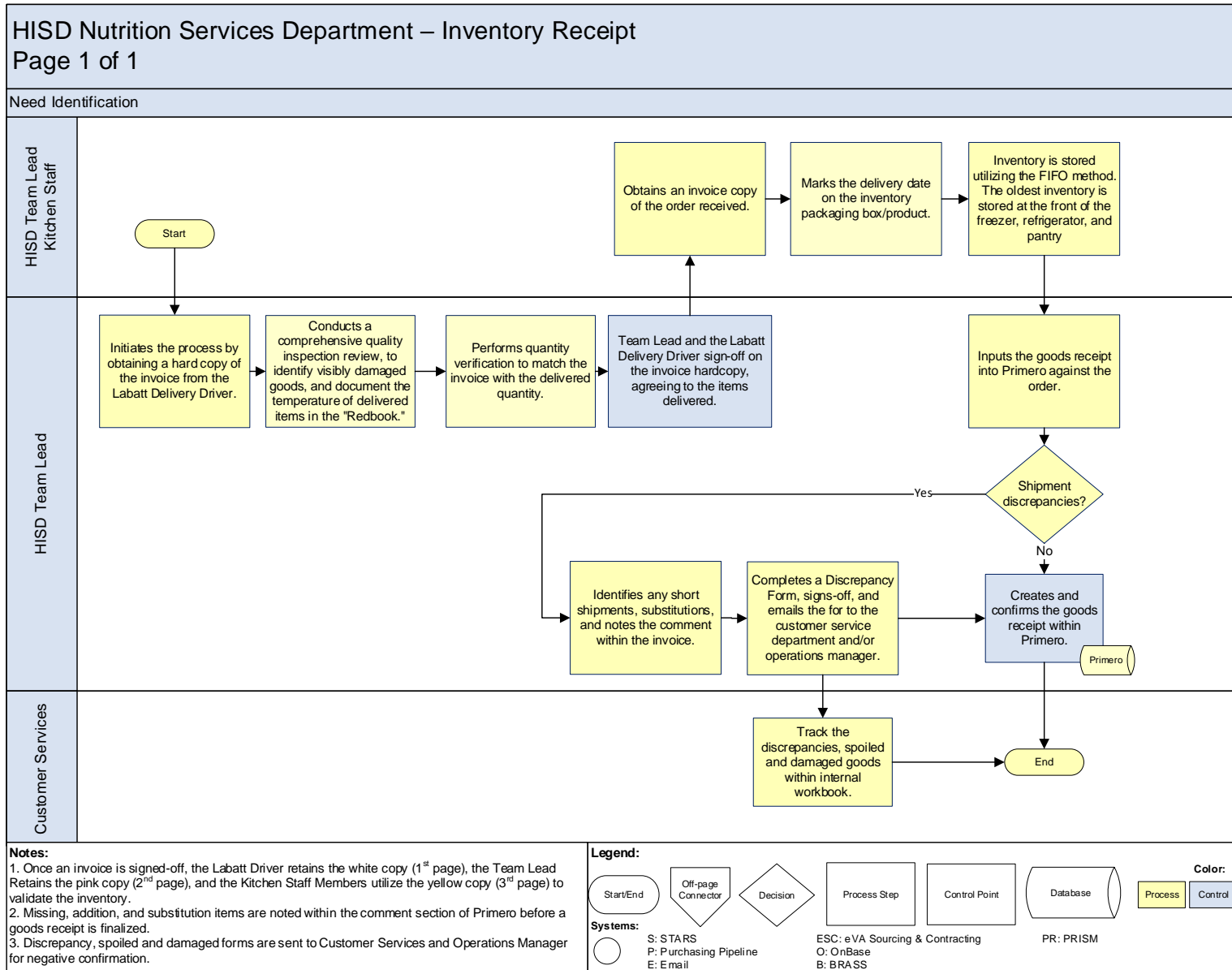


OBSERVATIONS MATRIX (CONTINUED)

Observation	7. Utilization of Bennington Warehouse Facilities
Low	<p>Based on an RSM site visit and management inquiry, the Hexser T. Holliday Food Services Support Facility ("Bennington Warehouse"), located at 6801 Bennington St, Houston, TX 77028, is underutilized with significant annual costs. Therefore, opportunities to better utilize the space (i.e., reconfigure, transform, sell, etc.) may exist and should be considered against current expenses and utilization.</p> <p>The Bennington Warehouse, previously central to the NSD in-house food production, food/supply warehousing and operations, has been decentralized to school kitchens, where the Broadline Distributor delivers food and goods to each kitchen and the NSD personnel prepare, cook, and serve the meals to the students. Based on inquiry and an on-site visit, 158,400 square feet (80%) of the first floor of the building is underutilized or unnecessary based on current operations. FY 2023, expenditures for the Bennington Warehouse amounted to \$4,348,980. The underutilization of the 219,000-square-foot Bennington Warehouse and its maintenance costs presents HISD with financial and operational challenges and underscores several opportunity costs.</p>
Recommendation	<p>HISD NSD should consider the following recommendation:</p> <ol style="list-style-type: none"> 1. Perform a cost-benefit analysis of the Bennington Warehouse. This analysis should evaluate current and potential uses' economic impact, including repurposing the real property or equipment for District needs or sale. The findings should guide strategic decisions to enhance resource allocation towards the primary objectives of the NSD and improve overall District efficiency.
Management Action Plan	<p>Response: The Office of the Chief Financial and Operations Officer, in collaboration with NSD, acknowledges the findings from the internal audit regarding the underutilization of the Bennington Warehouse. We understand the purpose for which the building was originally built has changed. The change in the purpose of the building has caused this building to be underutilized and thus become surplus. We realize the financial impact to the general operating budget. We are in the process of moving NSD to a more suitable site. This process for NSD has begun. In the future, we will take to the Board of Managers a listing of this building as surplus property to approve for auction and sale.</p> <p>Responsible Party: Chief Financial and Operations Officer</p> <p>Estimated Completion Date: June 30th 2025</p>

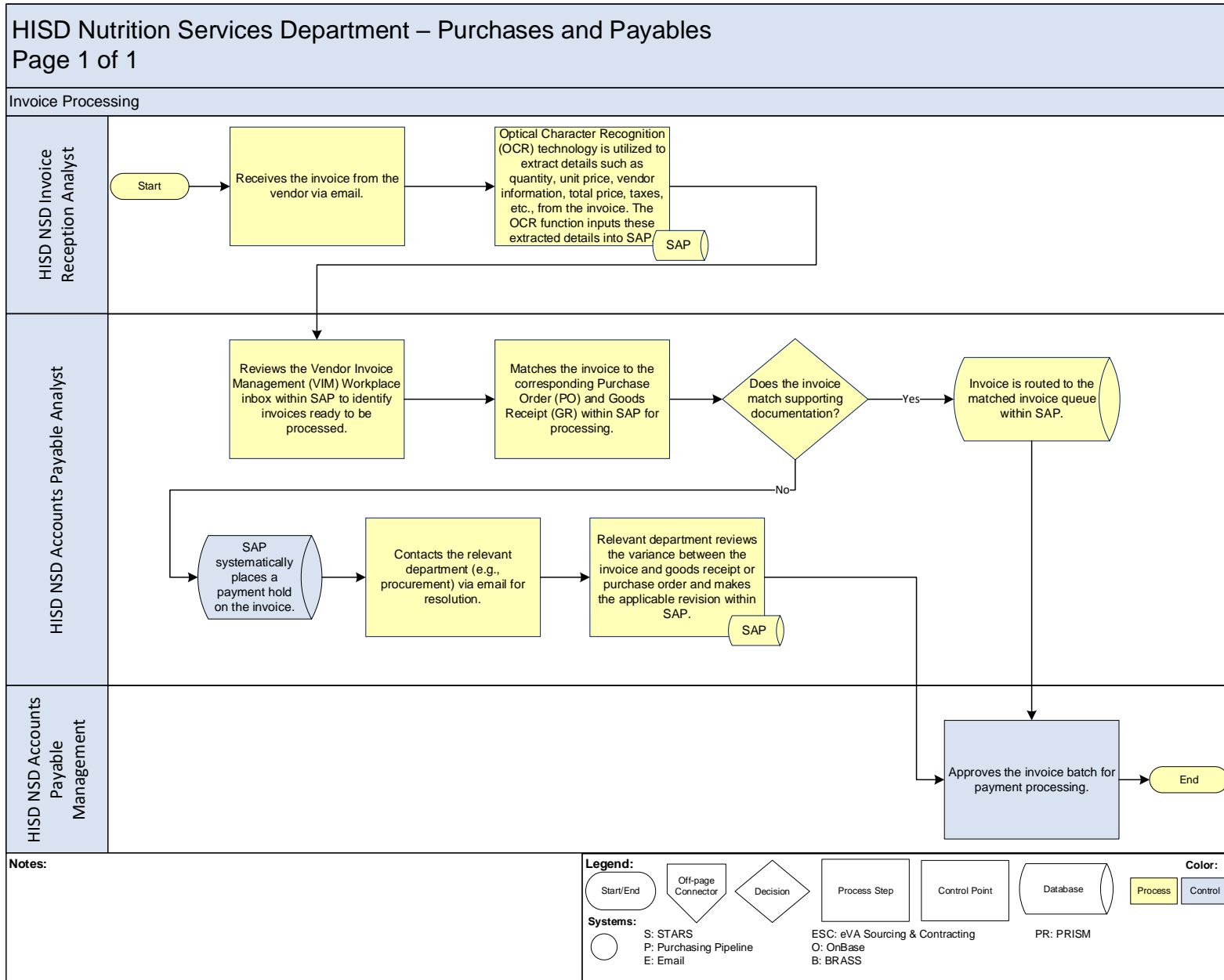



APPENDIX A – INVENTORY RECEIPT





APPENDIX A – INVOICE PROCESSING





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Houston Independent School District Internal Audit Report: NIST CSF, Enterprise Data Warehouse, and Logical Security/Privileged Access Management Assessment

April 1, 2024



TRANSMITTAL LETTER

April 1, 2024

The Audit Committee of
Houston Independent School District
4400 W 18th St.
Houston, Texas 77092

Pursuant to the approved internal audit plan for fiscal year ("FY") 2023-2024 for Houston Independent School District ("HISD"), we hereby submit the internal audit assessment of NIST CSF, Enterprise Data Warehouse, and Logical Security/Privileged Access Management. This internal audit focused on evaluating the adequacy and effectiveness of HISD's cybersecurity framework, data management practices, and access control mechanisms to support the confidentiality, integrity, and availability of critical information assets. We will present this report during the Audit Committee meeting scheduled for April 16, 2024.


The subject matter covered is confidential in nature, and thus specific details are not disclosed to avoid the possibility of compromising District information and security. This exemption is included in the Texas Freedom of Information Act, Texas Government Code, and other laws and rules requiring public access or disclosure. ***The full report contains confidential information, and an overview of the results will be presented in a closed session to the Audit Committee of HISD on April 26, 2024.***

In conjunction with this assessment, we have provided management with recommendations and related results. The information in the confidential report is intended to assist the District in enhancing its processes and controls.

We would like to thank the staff and all those involved in assisting the Internal Auditors in connection with this project.

Respectfully Submitted,

Internal Audit



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Houston Independent School District

Risk Assessment and Proposed Internal Audit Plan – Fiscal Year 2024-2025

February 29, 2024



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TRANSMITTAL LETTER

February 29, 2024

The Audit Committee of
Houston Independent School District
4400 West 18th Street
Houston, Texas 77092

Pursuant to the approved internal audit plan for fiscal year (“FY”) 2023-2024 for Houston Independent School District (“HISD”), we hereby submit the risk assessment for the development of the proposed internal audit plan for FY 2024-2025. We performed this risk assessment by applying a broad-based business view of risk linked to the annual budget and operations. We also conducted interviews with the HISD Superintendent and senior leadership to gain an understanding of their objectives and perception of risks. For this risk assessment, ‘risk’ focuses on financial, strategic, performance/operational, and compliance risk, as well as the general effect of public perception concerning districtwide activities and initiatives.

For each high-risk audit area identified, we have provided a process overview of each proposed audit function/area, the key potential inherent risks, and the audit strategy for evaluating the effectiveness of the processes, procedures, and controls within the function.

The following sections organize our report:

Executive Summary	This section summarizes the risk assessment objective, approach, and results. It includes the proposed internal audit plan and other inherently high-risk audit areas for consideration.
Process Overview	This provides a high-level overview of our objectives, definitions of the risk classifications, risk assessment methodology, and interview listing.
Proposed Internal Audit Plan	This section lists proposed internal audits, including a brief narrative of the audit area, inherent risks, and proposed audit strategy.
Additional Identified High-Risk Audit Areas	This section includes a listing of other potential internal audit areas based on the results of our risk assessment procedures.

We want to thank all those who assisted us with this risk assessment to develop the proposed internal audit plan for FY 2024-2025.

Respectfully Submitted,

RSM US LLP

Internal Audit



EXECUTIVE SUMMARY

Objectives

The risk assessment process is intended to assist in analyzing risk impacting HISD's current operating environment, including inherent and residual impacts and likelihood, and to identify the key risks impacting the current operating environment, functions, and activities. Objectives included the following:

- Documentation of HISD's common, unique and shared risks.
- Identification and prioritization of keys risks.
- Creation of HISD's Audit Universe.
- Development of HISD's Proposed Internal Audit Plan FY 2024-2025.

Approach

1. Identify and Measure Risk

- Conducted interviews with key stakeholders to identify current risks.
- Conducted a risk assessment survey with key stakeholders across legal services, finance, and business operations to identify key risks.
- Reviewed the District's adopted budget books, financial statements, current events, prior risk universe, and other information as deemed applicable.

2. Prioritize Risk

- Evaluated the level of risk within each process area based on the frequency with which it was mentioned during the interviews/survey, our review of source documents described above, and the severity of potential impact on District operations and fulfillment of objectives.
- Evaluated risk across various industry-accepted risk categories, such as: Control Environment, Process, Change, External Factors, and Materiality.

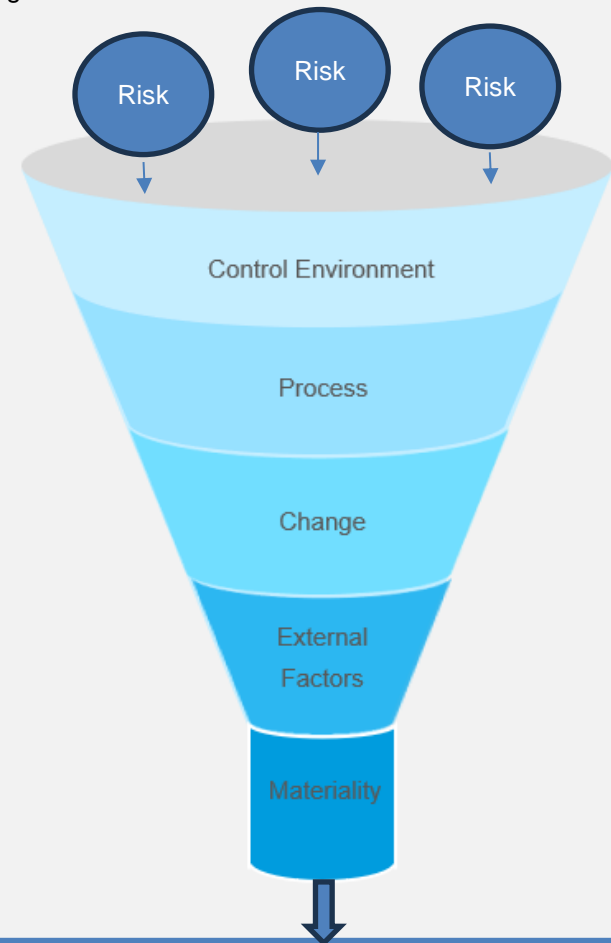
Note: Our review did not include detailed testing of source documents.

3. Communicate Results

- Prepared the audit universe.
- Reviewed this Risk Assessment / Proposed Internal Audit Plan with Management.
- Reviewed risk profile and deliverable with the Audit Committee and the Board.

Risk Assessment Process

We evaluated the level of risk present in each area / function, across a standard spectrum of industry-accepted risk categories as follows:



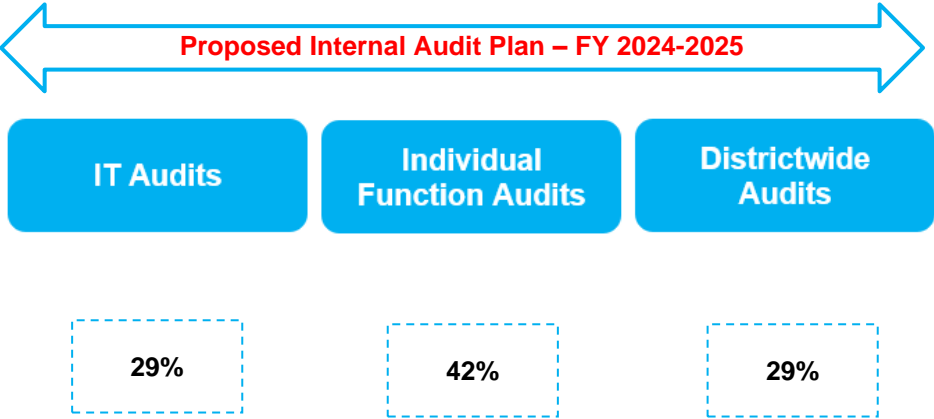
Proposed Internal Audit Plan – FY 2024-2025



EXECUTIVE SUMMARY – CONTINUED

This risk assessment aims to identify areas with a relatively high-risk profile or that require internal audit attention for various reasons. The proposed internal audit plan below was designed to fit the District’s current budget allocation for its internal audit function.

The proposed audit plan’s breakdown is a strategic allocation, with 29% dedicated to Information Technology (IT) projects. Leading practices in mature internal audit functions dedicate 20-35% of their resources to IT risks. Additionally, 42% of our proposed audit plan is directed toward Individual Function Audits. The remaining 29% is attributed to districtwide audits.



Proposed Internal Audit Plan FY 2024-2025
Required Internal Audit Activities*
Risk Assessment – Refresh (FY 2025-2026) <p>This report shows that annual risk assessments are critical for internal audit activities, providing a systematic approach to identifying and evaluating risks. This process aligns the audit plan with the District's changing risk landscape and priorities, enabling a proactive focus on areas of concern. Conducting risk assessment is also in line with best practice guidance, including that of the Institute of Internal Auditors (IIA), validating the audit's relevance and effectiveness.</p>
Follow-up Testing <p>Follow-up in the internal audit process verifies the implementation of management actions or acknowledges risks of inaction. It involves re-evaluating previously identified areas of concern and reporting regularly to the Audit Committee for transparency and accountability. This approach is in line with IIA guidelines and best practices.</p>

**The activities above are required activities of an internal audit function, per the Institute of Internal Auditors industry guidance. They will be included in the internal audit plan every fiscal year.*



EXECUTIVE SUMMARY – CONTINUED

Proposed Internal Audit Plan FY 2024-2025 – Continued	
Proposed Internal Audits	
1. Information Technology – Internal Penetration Testing and Social Engineering	The District conducts annual external penetration testing, but internal penetration testing is limited to every two years, and social engineering testing is not performed. By increasing the frequency of internal penetration testing and introducing periodic social engineering testing, the District can identify vulnerabilities beyond those addressed by external testing, strengthening its preparedness against the dynamic and evolving landscape of cybersecurity threats.
2. Information Technology – Incident Response Tabletop Exercise	An Incident Response Plan (IRP) is a proactive and collaborative strategy designed to improve an organization's preparedness for cybersecurity threats. An IRP should be conducted to validate the efficiency and effectiveness of emergency preparedness. Internal Audit will facilitate Tabletop exercises to assist team members in reviewing their responsibilities during an emergency.
3. Human Resources – Extra Duty Pay	This proposed internal audit will focus on policy compliance, thorough documentation and record-keeping, authorization and approval processes, effective internal controls to prevent fraud, budgetary compliance, and transparent communication to ensure fairness and equal participation in extra duty assignments. The evaluation would further enhance transparency, compliance, and efficiency in allocating and managing extra duty pay within the District.
4. Districtwide – Activity Funds Review	This proposed internal audit aims to assess the effectiveness of controls safeguarding activity funds in accordance with relevant regulations and District policies.
5. Controller's Office – Asset Management	This proposed internal audit will assess internal controls related to asset recording, monitoring, and safeguarding, with procedures covering asset additions, transfers, disposals, tracking, and inventory counts, excluding real property.



EXECUTIVE SUMMARY – CONTINUED

Proposed Internal Audit Plan FY 2024-2025 – Continued

Individual Internal Audits – Continued

6. Purchasing Services – ProCard Program

This internal audit will assess the Purchasing Services Department’s management of the ProCard program, focusing on compliance with the ProCard Cardholder Contract and the Purchasing Manual. Given the high-risk nature of the ProCard program, as identified in the 2016 operational audit, and the incomplete implementation of recommended actions from the 2019 follow-up, the audit will evaluate the effectiveness of policies and review processes in preventing inappropriate purchases and identify areas needing attention and improvement.

7. Districtwide – Timekeeping / Overtime

The internal audit will focus on timekeeping accuracy within HISD, a critical factor for organizational integrity and fair compensation, given the significant budget allocation for salaries in FY 2023-2024 (\$1.52B). Following the FY 2021 evaluation of Payroll Overtime, which identified five reportable observations, the audit will assess the effectiveness of internal controls and the recently implemented Time Clock Plus system, identifying potential issues.

Including a proposed internal audit area does not necessarily mean ‘issues’ or concerns currently exist. Instead, the function's high-risk nature makes issues more likely to develop.



EXECUTIVE SUMMARY – CONTINUED

Our risk assessment identified additional high-risk audit areas not included in the proposed FY 2024-2025 audit plan. These details are provided in our risk assessment report, which will be communicated to the Audit Committee, Board, and Superintendent to increase awareness of such risks. We will continue to monitor these areas for consideration in future years or if the audit plan expands or changes in the current year.

These audit areas are not listed in any particular order. The additional identified high-risk audit areas include the following:

Additional Identified High-Risk Audit Areas	
8.	Districtwide – Contract Administration
9.	Federal and State Compliance – Student Discipline
10.	Federal and State Compliance – Student Transcripts
11.	Transportation Services – Fleet Management
12.	Public Information Office – Public Records
13.	Business Operations – Maintenance & Repairs
14.	Business Operations – Construction Services
15.	Transportation Services – Operations
16.	Controller’s Office – Payroll
17.	Purchasing Services – Vendor Master File
18.	Human Resources – Employee Selection and Onboarding
19.	Federal and State Compliance – Student Enrollment (FTE)
20.	Purchasing Services – Contract Negotiation



PROCESS OVERVIEW

This risk assessment aims to perform an enterprise-wide evaluation of the risk that will be used to develop a Proposed Internal Audit Plan for FY 2024-2025. The purpose is to identify areas with a relatively high-risk profile or require audit attention for various reasons. This document is online, in real-time, and labeled as proposed because it is a living document. The proposed internal audit plan can and will change as factors change and situations arise. As part of this assessment, 'risk' focuses on factors such as technology, external factors, human resources, financial, strategic, performance/operational, compliance risk, and the general effect of public perception related to districtwide activities and initiatives. Our approach is based on the widely accepted guidance of the Committee of Sponsoring Organizations ("COSO") on monitoring internal control systems, as shown below.

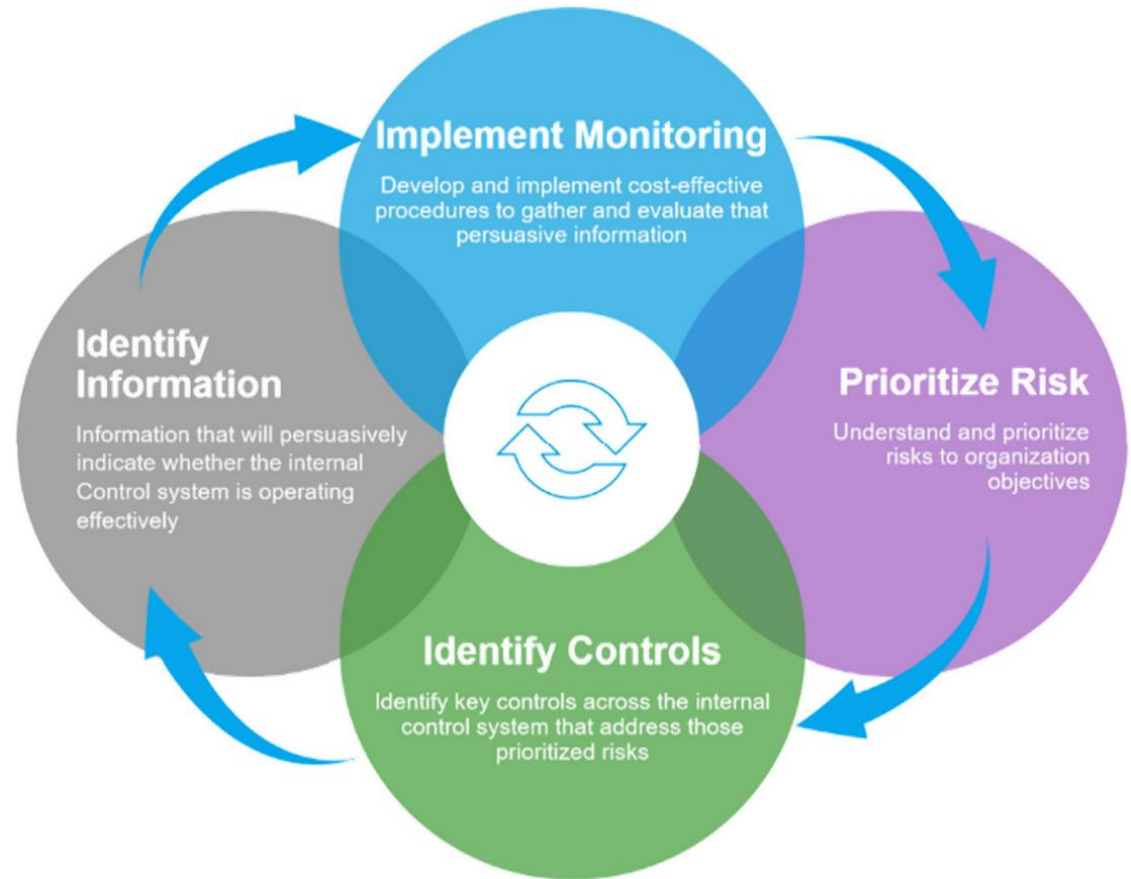
Our analysis of high-risk areas considers 'inherent risk,' which is the risk of a function in an environment void of controls. Therefore, functions with inherently high risk are included in the assessment. The high-risk areas of focus listed in this profile are a point-in-time depiction and should be considered a living document. As factors change and situations inevitably arise, the risks identified can and will change.

Inherent Risk

- Risk of an occurrence before the effect of any existing controls.
- If you were building this process, what would you be concerned about?
- What can we not prevent?

Residual Risk

- Risk remaining after the application of controls.
- Potentially reduced impact or likelihood.





PROCESS OVERVIEW – CONTINUED

Our risk assessment was conducted utilizing a broad-based business view of risk. We conducted seventeen (17) interviews with various leaders, including the HISD Superintendent, Senior Staff, and General Counsel, to understand their risk perspective, focusing on their objectives to identify potential risks. We also conducted an anonymous survey across fifteen (15) departments to identify risks, vulnerabilities, and potential opportunities. In addition, we reviewed adopted budget books, financial statements, media coverage, school board meeting agendas, minutes, and other available documentation. Our research and discussion with various levels of leadership within the District provide broad insight and understanding of potential risk from the perspectives of key process owners.

We evaluated the level of risk present in each area/function across a standard spectrum of industry-accepted risk categories as follows:

Control Environment	Describes the overall tone and control consciousness of the process/function. It involves personnel integrity, ethical values, competence, management philosophy, and operating style.
Change	Addresses the extent to which change has affected or is expected (in the near term) to affect the process/function, including changes in key personnel, statutes, the organization, its products, services, systems, or processes.
Process Risk	Addresses the inherent risk of the activities performed by the process/function, including assets managed or in the custody of the process/function. Process risk addresses the extent of support the process/function provides to vital District functions, including the threat to the continuity of the District caused by failures or errors: the probability of failure due to the amount of judgment, academic, or technical skill required to manage the unit or perform key activities.
External Factors	Describes the environment in which the process/function operates and the type and amount of external interaction in which the process/function engages. Factors to consider include the overall District and regulatory environment, the level of interaction with stakeholders and success in satisfying their requirements, the financial reporting environment, and the results of regulatory compliance audits.
Revenue Source / Materiality	Describes resources available and expended by the process/function. Factors to consider include the originating source of funds for a process/function, function budget, function spend, availability and use of other resources, and significance of impact to the overall operation of the District.

A robust, high-functioning internal audit process has a balance of all types of internal audits and reviews. These should include systematic audits selected through the risk assessment, ad hoc audits as new facts emerge, or requests by the board or management. In the Proposed Internal Audit Plan, we have included an overview of each process and a summary of the internal audit strategy for each audit, subject to modification during the initial planning stages and scoping of each audit and subsequent discussions with management.



PROCESS OVERVIEW – CONTINUED

A cornerstone of the risk assessment process is gaining feedback from management. To thoroughly understand the risk landscape within HISD, we executed an anonymous survey encompassing fifteen (15) departments. Additionally, we engaged in seventeen (17) interviews with key individuals as part of this assessment.

1. Catosha Woods, *General Counsel*
2. Ena Meyers, *Interim Chief Strategic Initiatives*
3. F. Mike Miles, *Superintendent*
4. Imelda De La Guardia, *South Division Superintendent*
5. James “Jim” Terry, *Chief of Finance and Operations Officer*
6. Jessica Neyman, *Chief Human Resources Officer*
7. Kari Fienberg, *Deputy Chief of Staff for Superintendent*
8. Kerri Briggs, *Chief of Staff*
9. Kristen Hole, *Chief Academic Officer*
10. Laura Stout, *West Division Superintendent*
11. Leila Walsh, *Chief Communications Officer*
12. Luz Martinez, *Central Division Superintendent*
13. Orlando Riddick, *North Division Superintendent*
14. Rebecca Dray Ballentine, *Deputy Chief of Staff for Superintendent*
15. Sandi Massey, *Chief of Leadership and Professional Development*
16. Scott Gilhousen, *Chief Technology Information Officer*
17. Shamara Garner, *Chief of Police*



PROPOSED INTERNAL AUDIT PLAN

1. Information Technology – Internal Penetration Testing and Social Engineering

Cybersecurity is an important priority within the public sector. Threats are constantly changing and evolving; thus, this area is inherently high risk. Organizations like the District are under constant attack from external attackers. The prospect of finding that an attacker has penetrated the District's defenses and can steal data from the District's network keeps most leaders up at night. As threats to data and systems have evolved, so have the requirements for safeguarding user, student, and District information. Likewise, it is essential to measure the security of technology assets to understand their ability to defend against threats. While the District performs external penetration testing annually, internal penetration testing is only performed every two years, and social engineering testing is currently not performed at all. Increasing the frequency of internal penetration testing and performing periodic social engineering testing will allow the District to be better prepared to address the changing and evolving cybersecurity threats.

Inherent Risks:

Undetected threats and attacks to District systems; loss or manipulation of critical data; systems and applications are not configured appropriately to support proper maintenance and monitoring; District data is not being stored securely; outdated, inappropriate, or incomplete response plans to ransomware/malware attacks, business email compromises, and data thefts; and monetary losses resulting from the cyberattack or litigation after the cyberattack.

Internal Audit Strategy:

To evaluate the efficiency of existing internal security measures by simulating a threat actor who has gained access to HISD's internal network. Meanwhile, social engineering assessments gauge the robustness of HISD's current security awareness program. This testing, which encompasses both manual and automated approaches, employs tactics and tools preferred by actual threat actors to accurately mirror a realistic attack scenario. The results of these tests will yield immediate, actionable remedies for quick wins alongside comprehensive strategic recommendations designed to enhance HISD's overall security posture.



PROPOSED INTERNAL AUDIT PLAN – CONTINUED

2. Information Technology – Incident Response Tabletop Exercise

An Incident Response Plan (“IRP”) is a proactive and collaborative strategy designed to improve an organization’s preparedness for cybersecurity threats. The IRP provides a roadmap for implementing the incident response, which should be tailored to the District’s mission, size, structure, functions, strategies, and goals. To make the IRP effective, Tabletop exercises should be conducted, where team members gather to review their responsibilities during an emergency. Beyond planning, the District must have proactive measures to hunt for potential signs of malicious activity within its network before any threat materializes.

Inherent Risks:

Inadequate preparation; poorly designed exercises; undocumented policies or procedures; data theft; monetary losses resulting from the cyberattack or litigation after the cyberattack; and time and resources may be inefficiently spent manually analyzing threats to District systems.

Internal Audit Strategy:

To review the District’s current IRP and evaluate the effectiveness and maturity of its Incident Response (“IR”) program. This includes reviewing documents referenced in the IRP surrounding notification and escalation procedure, impact and prioritization methods, disaster recovery and business continuity plan documentation, backup restoration procedures, threat hunting procedures, and reviewing tabletop exercises performed.

3. Human Resources – Extra Duty Pay

Extra duty pay at a school district typically refers to additional compensation provided to school employees for performing tasks or responsibilities beyond their regular duties. These additional responsibilities could include coaching sports teams, supervising extracurricular activities, organizing events, or taking on other leadership roles within the school community. According to the 2023-2024 HISD Compensation Manual, professionals paid on the Teacher Initial Compensation Placement Table who have assignments beyond the ordinary course and scope of their duties may be paid at the standard rate of \$25 per hour for the additional time worked. Such extra duty pay must align with policy requirements, be authorized in advance by the principal, and be supported by a timesheet.

Inherent Risks:

Lack of specific guidelines may lead to inconsistent interpretation and application, potentially resulting in unfair or inappropriate payments; failure to obtain proper approvals may result in financial misstatements; insufficient records, such as missing agreements or contracts, can lead to difficulties in verifying the legitimacy of payments; fraud or misuse of extra duty pay; lack of transparency or appropriateness of extra duty opportunities.

Internal Audit Strategy:

To assess the effectiveness, transparency, and compliance of the District’s extra duty pay system. This involves reviewing policies, documentation, approval processes, and internal controls to identify and mitigate inherent risks. The strategy would aim to enhance the integrity of the extra duty pay process, fostering trust and accountability within the District’s financial and operational framework.



PROPOSED INTERNAL AUDIT PLAN – CONTINUED

4. Districtwide – Activity Funds Review

According to Section 301 of the HISD Finance Procedures Manual, Activity Funds are defined as resources received and held by the school in a trustee capacity. These funds are intended to be either expended or invested in alignment with the conditions specified in the trust. Activity Funds comprise funds collected from various school-related activities, including fundraising events, student dues, donations, and investment interest. Any funds collected by District personnel from students fall under the category of activity funds and must be managed through activity fund accounts.

HISD consists of 274 schools distributed across different levels of education. Each school principal is personally responsible for adequately collecting, disbursing, and controlling all Activity Fund monies. This responsibility includes safeguarding funds, proper accounting and administration of fund transactions, and adequate training and supervision of all personnel designated to handle activity funds. School principals are not responsible for funds collected, disbursed, or controlled by parent Parent-Teacher Association or Parent-Teacher Organization (PTA/PTO), patron, alum organizations, or other outside organizations.

Inherent Risks:

Outdated, inadequate, or undocumented policies and procedures; inadequate staff training; inadequate segregation of duties; delayed deposits; and lack of oversight or transparency regarding funds collected.

Internal Audit Strategy:

To determine whether the controls safeguarding the school's activity funds are operating effectively and comply with relevant regulations and internal District policies and procedures. As part of our procedures, we will evaluate cash receipts, deposits, and disbursements.



PROPOSED INTERNAL AUDIT PLAN – CONTINUED

5. Controller's Office – Asset Management

Asset management is the process of recording, monitoring, and reporting on the District's tangible assets. Effective asset management practices are critical to maintaining accurate records and tracking all relevant asset information. Asset management policies aim to establish and promote measures that will enable the District to adequately safeguard and account for all of its property and comply with all applicable state, federal, and Board of Education rules, regulations, and procedures. This involves coordinating the annual physical inventory, recording acquisitions, deletions, and other changes into the fixed asset database files in a timely and appropriate manner, managing the transfer and disposition of surplus property, and providing the appropriate property-related information and training to School District departments and schools.

Fixed Assets Accounting handles the acquisition, retirement, and disposal of all land, buildings, equipment, vehicles, and furniture in the District. SAP is HISD's financial system of record. All purchases coded to the capital outlay accounts are subject to annual inventory and tracking. As per the 2022-2023 Adopted Budget, HISD is budgeted to expend \$78,141,716 in capital expenditures in 2023-2024.

Inherent Risks:

Outdated, inadequate, or undocumented policies and procedures; inadequate safeguarding of assets; ineffective internal controls over inventory processes; lack of compliance with policy and procedures; and lack of transparency in reporting to the board.

Internal Audit Strategy:

To assess the adequacy of internal controls related to recording, monitoring, reporting, and safeguarding tangible assets. The scope of our procedures may include the following: asset additions, transfers, and disposals; asset monitoring and tracking; and recurring inventory counts and related reporting. Our audit does not intend to include a review of controls or inventories over real property, including land and buildings.



PROPOSED INTERNAL AUDIT PLAN – CONTINUED

6. Purchasing Services – ProCard Program

The Purchasing Services Department functions as a compliance service entity tasked with procuring goods and services requested by the District. Within its purview, the Purchasing Services Department oversees the ProCard program. The ProCard Cardholder Contract and Agreement, in collaboration with the Purchasing Manual, delineate the duties related to the operation and management of the ProCard program. These governing policies specify the established procedures, covering the protection of the ProCard, acceptable use, and the verification and reconciliation processes for all account activities. This includes ensuring approvals for all ProCard transactions from the fund approver. The last operational audit of the ProCard program was performed in 2016 by the Office of Internal Audit. Follow-up procedures were performed in 2019, and it was found that only two of the agreed-upon recommendations in the 2016 audit report were implemented. Another two were partially implemented, and four were not implemented.'

The ProCard program is intended to give organizational leaders autonomy and efficiency in purchasing goods and services necessary to continue business operations. These tools shield department and school leadership from lengthy approval processes when time is of the essence and allow purchases with unencumbered funds or purchase orders. Because purchases are reviewed and approved after the expenditures have been made, ProCards use is inherently high-risk. Robust policies, procedures, and review processes are essential to detecting and preventing inappropriate purchases.

Inherent Risks:

Outdated, inadequate, or undocumented policies and procedures surrounding employee usage, supervisor review/approval, vendor payments, inventory of ProCards, etc.; insecure access to ProCards and inadequate ProCard monitoring; controls or segregation of duties for approving, furnishing, and reconciling ProCards are not adequate; reconciliation of invoices is not being performed timely; and fraudulent spending and use of ProCards.

Internal Audit Strategy:

To assess the adherence and effectiveness of policies governing the ProCard program, focusing on physical and usage security, segregation of duties, and compliance with ProCard policies. We will also review the proper authorization, ordering, and receipt of goods and services, ensuring policy alignment. Additionally, the evaluation will extend to the functionality of ProCard issuance, inventory management, reconciliations, and overall program monitoring.



PROPOSED INTERNAL AUDIT PLAN – CONTINUED

7. Districtwide – Timekeeping / Overtime

HISD is ranked as the largest school district in Texas, and it caters to a student population exceeding 189,000 across 274 campuses. As one of Houston's major employers, it employs approximately 29,000 team members. District timekeeping encompasses systematically recording and managing employees' work hours, serving as a cornerstone of organizational integrity. Accurate timekeeping facilitates fair compensation and bolsters employee trust and organizational credibility. This process includes reviewing timesheets, ensuring necessary approvals for regular and overtime hours, confirming the application of correct salary or hourly rates, and verifying that payroll disbursements accurately reflect the hours worked at the approved rate.

As per the 2022-2023 HISD Facts and Figures, HISD is budgeted to expend \$1,521,021,275 on salaries in 2023-2024. With this substantial investment, it is imperative to establish robust internal controls to uphold effective timekeeping and overtime processes. The overtime payroll process was evaluated by the Office of Internal Audit in 2021, which resulted in five reportable observations. The recent implementation of the Time Clock Plus system represents a significant change in the timekeeping infrastructure. While this system is intended to provide increased efficiency and accuracy, it is crucial to assess its effectiveness and identify any potential gaps or issues that may have arisen during the transition.

Inherent Risks:

Outdated, inadequate, or undocumented policies and procedures; inadequate controls to detect fraud, waste, and abuse; inadequate segregation of duties; non-compliance with policies and procedures; employees paid for time not worked or approved; potential for human error; inadequate documentation and retention of timekeeping records; insufficient training; and ineffective accounting and administrative controls over tracking, recording, monitoring, and reporting.

Internal Audit Strategy:

To evaluate whether the internal control structure over time tracking, recording, monitoring, and reporting is appropriately designed and operating effectively to mitigate inherent risk. Procedures will evaluate whether records and documentation retained at the department level are complete and accurate, appropriately reviewed and approved, and processed correctly and timely. Additionally, we will assess the effectiveness of existing policies and procedures related to overtime management and evaluate the effectiveness of internal controls to monitor and approve overtime.



ADDITIONAL IDENTIFIED HIGH-RISK AUDIT AREAS

Our risk assessment identified additional high-risk audit areas that are not included in the proposed FY 2024-2025 audit plan. We provide these details in our risk assessment report to communicate to the Audit Committee, Board, and Superintendent to raise awareness of such risks. We will continue to monitor these areas.

These audit areas are not listed in any particular order. The additional identified high-risk audit areas include the following:

8. Districtwide – Contract Administration

Contract administration encompasses overseeing and managing the execution, implementation, and fulfillment of awarded contracts. It involves vendor monitoring, enforcing compliance with contractual terms, conditions, and obligations, and adhering to relevant legal and regulatory requirements. Performance assessment is integral, utilizing key performance indicators to evaluate all parties involved, measure success, and identify areas for improvement. Furthermore, maintaining a comprehensive and organized documentation system throughout the entire contract lifecycle, including amendments, communications, and any modifications, is imperative. Additionally, managing the financial aspects of the contract, such as payment terms, schedules, and the verification and approval of invoices, constitutes a significant responsibility within the broader spectrum of contract administration.

In 2021, the Office of Internal Audit conducted a comprehensive audit of contract management within the District. However, it's important to note that this internal audit occurred before introducing the new IonWave contract management system. Implementing this system represents a significant shift in the District's approach to contract management. Furthermore, an evaluation of vendor management was not included in the scope of work performed in 2021. As per the 2022-2023 Adopted Budget, HISD is budgeted to expend \$497,857,204 in contracted services in 2023-2024. With this substantial investment, it is imperative to establish robust internal controls to uphold effective contract administration processes.

Inherent Risks:

Outdated, inadequate, or undocumented policies and procedures; inadequate segregation of duties; non-compliance and inconsistencies with policies and procedures; non-performance of vendors; inadequate vendor monitoring and management; and failure to meet select contract provisions.

Internal Audit Strategy:

To assess whether the system of internal controls over contract administration is adequate and appropriate for promoting and encouraging the achievement of management's objectives for effective contract monitoring and administration. Our procedures will include reviewing District policies and compliance procedures. We will assess the accuracy of contract execution and analyze the contract administration process for potential improvements. Our audit procedures will include detailed testing of a sample of awarded contracts to verify service delivery and evaluate compliance with contractual obligations, legal requirements, and internal policies. Additionally, we will review internal controls to assess their effectiveness in safeguarding assets and promoting vendor accountability.



ADDITIONAL IDENTIFIED HIGH-RISK AUDIT AREAS – CONTINUED

9. Federal and State Compliance: Student Discipline

School districts are reporting an increase in student behavior incidents nationally, resulting in discussions to identify contributing factors and solutions. According to the 2022-23 Student Discipline Report from the Research and Accountability Department, the academic year 2020–21 saw remarkably low disciplinary action rates, influenced by the disruptions caused by the COVID-19 pandemic. However, in the subsequent academic years, 2021–22 and 2022–23, the rates surged to comparable levels before the pandemic. In the 2022–23 academic year alone, the District recorded 189,290 disciplinary incidents.

The repercussions of such behavior extend beyond the immediate incidents, impacting employee and student retention—an escalating concern for school districts. The 2023-24 academic year has witnessed a substantial decline in student enrollment, with a noteworthy drop of approximately 6,000 students, marking the second-steepest decline in the past decade. Concurrently, districts face the complex task of addressing the concerns raised by students, parents, faculty, and school boards nationwide. Within HISD, the challenge is evident in the significant increase in teacher resignations, with 633 teachers stepping down between August and early January, surpassing the 331 resignations during the same period in the 2022-23 school year and the 309 resignations the year before. Launched at underperforming campuses across HISD in the fall of 2023, the New Education System (“NES”) is designed to enhance the support provided to students and teachers through additional resources. HISD launched the NES at 28 historically underperforming campuses in the 2023-24 academic year. 45 schools will join the NES in the 2024-25 academic year. Expanding the NES program provides an opportunity to assess the program's impact on student discipline strategies and evaluate alignment with broader goals in addressing academic and behavioral challenges across the District.

The Texas Education Data Standards encompass information pertaining to the reporting of disciplinary records to the Texas Education Agency (“TEA”). As per TEC 37.008(m-1), the failure to report all instances of disciplinary removals and truancy actions, as mandated by state and federal law, could prompt a review by the commissioner of education. Any identified issues in the District's data or violations of laws and rules may result in notification to the local school board. The Department of Student Discipline supports parents, students, central office, and campuses with student-discipline-related issues, questions, and concerns, specifically, the review, approval, and processing of referrals to the Discipline Alternative Education Program (“DAEP”) and expulsions to the Juvenile Justice Alternative Education Program (“JJAEP”). The Department of Federal and State Compliance requires Senior Student Information Representatives to review campus discipline records and periodically provide guidance as necessary. The District relies on two essential resources, namely the Code of Student Conduct and the Discipline Policies and Procedures Manual, to effectively communicate the pivotal roles and responsibilities integral to the student discipline process.

Inherent Risks:

Outdated, inadequate, or undocumented policies and procedures surrounding corrective actions, alternative placement, and approval processes; non-compliance with applicable policies, laws, and regulations; and reputational damage to the District.

Internal Audit Strategy:

To determine compliance with federal and state laws and the policies of the Board of Education and Administrative Regulations. This includes performing data analytics with available data and interviews with key District stakeholders to understand the culture encompassing student discipline, including any trends identified when comparing student incidents to HISD's NES.



ADDITIONAL IDENTIFIED HIGH-RISK AUDIT AREAS – CONTINUED

10. Federal and State Compliance – Student Transcripts

HISD consists of 274 schools distributed across different levels of education. This includes 8 early childhood schools, 159 elementary schools, 39 middle schools, and 37 high schools. Additionally, the District has 31 combined or other types of schools. The District serves a substantial student population of over 189,000 students.

Student transcripts are official documents that comprehensively record an individual student's academic history and accomplishments. These transcripts encompass details about the student's enrolled courses, received grades, earned credits, and other pertinent academic information. Serving as a crucial document, the transcript is pivotal in monitoring students' progress throughout their educational journey. The District must establish a robust process for managing student transcripts, ensuring the security of student data, and upholding the institution's reputation and service quality for its students.

Inherent Risks:

Incomplete or inaccurate student data; duplicative enrollment; erroneously earning credit for uncompleted coursework; students missing major course credits; non-compliance with policies and procedures; record loss; and reputational damage to the District.

Internal Audit Strategy:

To evaluate the effectiveness of the District's management of student transcripts. This would include assessing the completeness and accuracy of transcript data, reviewing procedures for recording, updating, and issuing transcripts, evaluating controls to prevent and detect errors or fraud, and verifying compliance with relevant laws and regulations.



ADDITIONAL IDENTIFIED HIGH-RISK AUDIT AREAS – CONTINUED

11. Transportation Services – Fleet Services

The Transportation Department is the largest single-district provider of school bus service in the state of Texas. The Transportation Department employs over 1,400 employees and operates roughly 1,100 buses. It uses 990 buses to transport approximately 36,000 students to and from school daily. As per the 2022-2023 Adopted Budget, the Transportation Department has a budget of \$47,122,293.

The Fleet Operations division is responsible for purchasing and maintaining HISD's fleet, including school buses, support, service, utility, and delivery vehicles. This is performed utilizing one Truck Service Center and four regional service centers: Barnett Service Center, Butler Service Center, Central Service Center, and Northwest Service Center. Effective internal controls are necessary to govern the tracking, recording, and management of District fleet assets, including acquisition, maintenance, and disposal.

Inherent Risks:

Operational disruption or failure; financial loss; reputational damage; inability to meet strategic District growth goals; inadequate segregation of duties; inadequate safeguarding of vehicles; and non-compliance with policies and procedures.

Internal Audit Strategy:

To evaluate fleet management processes and internal control structure to assess the efficiency and effectiveness of fleet management processes, including vehicle purchases, assignment, retirement, and maintenance procedures.



ADDITIONAL IDENTIFIED HIGH-RISK AUDIT AREAS – CONTINUED

12. Public Information Office – Public Records

Chapter 552 of the Texas Government Code ('The Public Information Act') provides the authority under which a member of the public may access government records. Public records refer to any written information prepared, owned, used, or retained by the District and associated with performing public duties. These records can take various forms: papers, letters, maps, books, tapes, films, sound recordings, and other information stored. Public records exist to provide transparency into the District's operations.

It is the responsibility of the District to coordinate a public records request from any entity making that request and ensure all requests comply with the Texas Government Code. The Public Information Office is responsible for working with the members of the general public to provide access to publicly available information that is collected or maintained by HISD. It is the mission of the Public Information Office to deliver accurate and timely responses to public information requests by HISD policy and state and federal laws.

Inherent Risks:

Data security issues include improper dissemination of incorporation, failure to comply with the Texas Government Code, inability to protect sensitive data, lack of authorized users and audit trails, and non-compliance with relevant laws and regulations.

Internal Audit Strategy:

To review the handling of public records requests, assess compliance with legal mandates, and evaluate the effectiveness of public records management policies and procedures. Examine the alignment of the District's record retention and destruction policies with legal requirements, emphasizing access controls, technology implementation, training initiatives, and continuous monitoring procedures in public records management.



ADDITIONAL IDENTIFIED HIGH-RISK AUDIT AREAS – CONTINUED

13. Business Operations – Maintenance & Repairs

The Facilities, Maintenance, and Operations Department maintains all HISD facilities. The Maintenance & Repairs Department oversees the repair and upkeep of the District's mechanical systems and overall building operations, which includes the services of HVAC, Electrical, Plumbing, Structural, Roofing, Environmental Services, Hazardous Materials, and DDC Control. The Maintenance & Repairs Department is responsible for District facilities and a total of 274 schools and 31 combined or other types of schools within the District. As per the 2022-2023 Adopted Budget, the Facilities, Maintenance, and Operations Department has a budget of \$141,277,379. Recently, the District has experienced turnover within the Operations Division, including the Chief Operations Officer, which remains vacant. The District has a backlog of \$1.2 billion in deferred maintenance costs. Management prioritizes all work orders based on defined facilities services work order categories: Emergency, Routine, and Deferred/Scheduled Work. The response time and completion dates will vary based on the priority associated with the work order.

Timely repair and preventative maintenance of these assets will prolong their useful life and potentially reduce the future cost of renovation, repair, and replacement. Although many preventative and repair functions are performed with in-house labor, the size and scope of maintenance throughout the District require third-party vendors for certain services. Work orders are used to manage, organize, and track the work performed. A critical part of the maintenance process is control around accumulating and properly allocating maintenance expenditures, such as employee time spent and inventory/parts used for a specific project.

Inherent Risks:

Inadequate or undocumented policies and procedures; inaccurate accumulation or allocation of time and materials to work orders; ineffective monitoring and reconciliation of the work order system; inadequate monitoring of work order distribution, production, and overtime; untimely response/priority of work orders and needs of the District; and inadequate monitoring of key performance indicators, such as work order turnaround, employee productivity, and parts utilization.

Internal Audit Strategy:

To assess whether the system of internal controls within the Maintenance & Repairs Department is adequate and appropriate for promoting and encouraging the achievement of management's objectives in compliance with applicable laws, administrative rules, and other guidelines. The review may focus on the Maintenance & Repairs function's process for procurement of goods and services; management and administration of vendors and contracts; monitoring processes; work identification and prioritization; work completion and review; utilization of work order system; and internal performance monitoring.



ADDITIONAL IDENTIFIED HIGH-RISK AUDIT AREAS – CONTINUED

14. Business Operations – Construction Services

Construction Services is responsible for school construction across the District, including all new construction, major renovations, and all projects related to District bond programs. The \$1.89 billion 2012 Facilities Capital Program is funded from the bond issue approved by voters in November 2012. Additionally, the board approved \$212.4 million in October 2015. The 2012 Bond program consists of new construction and repair of 40 schools across the District, technology upgrades, the replacement of regional field houses and athletic facility improvements, middle school restroom renovations, and safety and security improvements. More than 85 percent of all school construction projects are complete, with two schools remaining under active construction. The Construction Services Department was charged with selecting program managers who were responsible for managing the architects, engineers, and general contractors to carry out projects from planning to completion. The Bond Oversight Committee, an independent citizen's committee composed of building and construction professionals and community members, was created to ensure that the various projects stay on track and that taxpayer dollars are spent wisely. The Construction Services Department provides the Bond Oversight Committee with regular updates, status reports, and program information.

Additionally, the Construction Services Department manages projects, including 10 schools, from other sources unrelated to the 2012 bond. Some of the many responsibilities of the Construction Services Department include activities such as construction planning, managing the design and construction, contracting, and monitoring contractors (i.e., vendor performance). Without a robust and well-defined program, the District could face non-compliance with various laws and regulations and engage with poor-performing vendors.

Inherent Risks:

Outdated, inadequate, or undocumented policies and procedures; inadequate scoping leading to projects exceeding budgets; non-compliance/improprieties with State Statutes and District policies for solicitation and procurement; inappropriate spending due to non-compliance with vendor contract terms; non-performance of vendors; failure to meet select contract provisions; construction does not meet specifications; projects are not completed on schedule; inadequate and untimely review of invoices and change orders; and inadequate documentation and audit trail of projects.

Internal Audit Strategy:

To assess whether the system of internal controls is adequate and appropriate for the categories of compliance with applicable laws, administrative rules, and other guidelines. It will focus on the control structure surrounding the procurement of construction-related contracted goods and services, including contract negotiation and budget development; project management activities, including the invoice review, change order review, and vendor performance monitoring.



ADDITIONAL IDENTIFIED HIGH-RISK AUDIT AREAS – CONTINUED

15. Transportation Services – Operations

The Transportation Department's goal is to support students and teachers by providing reliable and efficient transportation. The Transportation Operations, Routing & Scheduling, Payroll, Fleet Services, and Field Trips Sections assist the daily professional contribution of the drivers and transportation supervisors. The Transportation Department is the largest single-district provider of school bus service in the state of Texas. The Transportation Department employs over 1,400 employees and operates roughly 1,000 buses to transport approximately 36,000 students to and from school daily. As per the 2022-2023 Adopted Budget, the Transportation Department has a budget of \$47,122,293. The last operational audit of Transportation Operations was performed in 2016 by the Office of Internal Audit. Follow-up procedures were performed in 2019 and found that 'three of the four agreed-upon recommendations from the 2016 audit were either implemented or partially implemented.'

The Transportation Operations Section comprises over 950 employees, including bus drivers, bus attendants, transportation clerks, and managers, whose primary responsibility is transporting students to school directly and related activities safely, timely, and orderly. The Routing & Scheduling Department assigns buses, safe bus stops, and bus routes. It maintains the database for transportation routes and prepares and maintains route schedules for all bus drivers, transportation District managers, and eligible schools.

Inherent Risks:

Non-compliance with applicable policies, laws, and regulations; ineffective safety protocols and procedures; lack of effective training; inefficient bus route processes; and lack of performance monitoring.

Internal Audit Strategy:

To identify areas of strength and areas for improvement in the transportation service and to provide recommendations for enhancing its efficiency, effectiveness, and compliance with laws and regulations. Our procedures would include an evaluation of the Transportation Department's compliance with relevant local, state, and federal regulations. We will assess the effectiveness of performance metrics used by the Transportation Department, such as on-time performance, efficiency of routes, and safety records. This includes analyzing whether these metrics align with organizational goals and contribute to continuous improvement.



ADDITIONAL IDENTIFIED HIGH-RISK AUDIT AREAS – CONTINUED

16. Controller's Office – Payroll

The Payroll Department processes payroll for HISD every other week. It is responsible for direct deposits, garnishments, teacher union deductions, approved stipends, and late-time correction payments. The Department is also responsible for providing accurate and timely employee payments while complying with state and federal laws.

As one of Houston's major employers, HISD employs approximately 29,000 team members. As per the 2022-2023 HISD Facts and Figures, HISD is budgeted to expend \$1,521,021,275 on Salaries in 2023-2024. These salaries comprise approximately 66.59% of the total estimated operating budget. While the Office of Internal Audit conducted an internal audit of Payroll in 2022, the scope of work was limited to evaluating compliance with the IRS payroll tax reporting regulations and state payroll tax and deduction requirements.

Inherent Risks:

Outdated, inadequate, or undocumented policies and procedures; inadequate controls to detect fraud, waste, and abuse; inadequate segregation of duties; non-compliance and inconsistencies with policies and procedures; employees paid for time not worked or approved; potential for human error; inadequate documentation and retention of timekeeping records; and ineffective accounting and administrative controls over tracking, recording, monitoring, and reporting.

Internal Audit Strategy:

To assess the effectiveness of existing policies and procedures related to payroll processing. An audit of Payroll processes would cover the procedures performed after the time is entered and submitted by the Departments through payout to the employees. This would include assessing compliance with labor laws, accuracy of payroll calculations, and effectiveness of internal controls in place to prevent and detect errors or fraudulent activities in payroll processing.



ADDITIONAL IDENTIFIED HIGH-RISK AUDIT AREAS – CONTINUED

17. Purchasing Services – Vendor Master File

Vendor selection for HISD must adhere to the procurement methods outlined in Chapter 44, section 44.031 of the Texas Education Code and gain approval from HISD's Board of Education before utilizing their goods and services. Before providing goods or services, all vendors must have an approved procurement instrument, such as a purchase order or blanket purchase agreement.

The vendor master file functions as a centralized repository housing essential information about vendors and suppliers engaged by the District. Effective vendor management within a school district necessitates ensuring the accuracy, completeness, and security of vendor information within this file. This critical database includes vital data such as vendor contact details, payment terms, and other pertinent information.

Within the District, the Purchasing Services Department is responsible for establishing and maintaining professional relationships with current and potential vendors. The Accounts Payable team heavily relies on the vendor master file for processing invoices, facilitating payments, and managing overall vendor relationships. A review of the vendor master file process was initially included as part of the FY 2023-2024 Internal Audit Plan but was postponed due to the District implementing a new software application.

Inherent Risks:

Inactive vendors; fraudulent or duplicative vendors; inaccurate or fraudulent payments; and inadequate segregation of duties.

Internal Audit Strategy:

To evaluate and assess the adequacy, effectiveness, and compliance of the internal controls related to the vendor master data within the District. Our review may include reviewing the procedures for onboarding new vendors, assessing the completeness and accuracy of vendor data, reviewing procedures related to the collection and maintenance of required documentation, reviewing access controls related to the vendor master file, assessing segregation of duties to prevent conflicts and fraud, evaluate the history of changes to the vendor master file, including audit trails to substantiate vendor changes.



ADDITIONAL IDENTIFIED HIGH-RISK AUDIT AREAS – CONTINUED

18. Human Resources – Employee Selection and Onboarding

HISD is among the largest employers in Houston, with approximately 29,000 employees. Most HISD personnel are assigned to schools and deliver services directly to students daily. Responsibilities within the Human Resources (“HR”) function include prospective employee recruiting, coordination, and oversight of candidate applications, interviews and selection, onboarding, performance evaluations, discipline, termination, and other forms of employee separation (e.g., retirement). Each process requires collaboration between HR and every other department in the District. Bringing the process together within an acceptable period and in compliance with rules, laws, and District policies is inherently challenging due to phases of the process being owned by multiple parties. From a financial, operational, compliance, and public perception perspective, these factors make the Human Resources department an inherently high-risk function.

One of the most critical activities of a high-functioning human resources department is the ability to process qualified candidates and execute successful onboarding processes. Employee hiring/onboarding refers to the procedures when an individual is externally hired to work for the District. The process for hiring/onboarding includes working collaboratively with different departments from initiation through the first day of employment. Multiple parties own phases of the process; thus, bringing the process together within an acceptable period and in compliance with rules, laws, and District policies is inherently challenging.

Inherent Risks:

Inefficient or ineffective collaboration between departments; outdated, inadequate, or undocumented policies and procedures surrounding job posting, recruiting, screening, and offers of employment; untimely candidate vetting and approvals; an inefficient hiring process impacting the ability to fill positions promptly; inadequate screening procedures leading to unqualified employees; and non-compliance with applicable policies, laws, and regulations.

Internal Audit Strategy:

To assess the selection, setup, and onboarding of employees. Aspects of the assessment would include but are not limited to, testing for completion of any required pre-employment consent forms, the performance of necessary background check activities, candidate vetting, the orientation process, employee setup, and timeliness to fill positions.



ADDITIONAL IDENTIFIED HIGH-RISK AUDIT AREAS – CONTINUED

19. Federal and State Compliance – Student Enrollment (FTE)

Student enrollment plays a pivotal role in educational funding and resource planning. An FTE represents the instructional hours provided to a student. Standardizing student engagement and workload allows fair comparisons across different contexts. Accurate enrollment data enables the District to allocate financial resources effectively, forecast trends, adapt to student needs, and track key performance indicators.

A large portion of HISD's funding is generated from the state, which bases its funding level on the average number of students attending district schools. Texas provides districts with \$6,160 base funding per student, a rate that has not changed since 2019. The Texas Education Agency oversees financing from the state. Through a complex formula, the program aims to provide all public school districts funding based on their attendance calculation. State law requires every Texas school district to adopt an attendance accounting system that includes procedures to ensure the accurate recording and reporting of student attendance data. The Student Attendance Accounting Handbook ("SAAH") contains the official attendance accounting requirements that all Texas public school districts and open-enrollment charter schools must meet.

Given the District's substantial student population of over 189,000, precise enrollment figures are critical for informed decision-making and successful educational outcomes. The Federal and State Compliance Department is responsible for maintaining data quality and analysis of record accountability. These responsibilities include monitoring the official Average Daily Attendance ("ADA") to promote accurate data and reconciling student membership. FTE is crucial in determining a school district's funding allocation from the state. Funding is often based on FTE enrollment, which considers the number of students and the intensity of their academic programs. Reporting enrollment inaccurately can result in misallocating funds, potentially costing the District financial resources needed for effective education delivery.

Inherent Risks:

Inaccurate or incomplete student data; operational inefficiencies or challenges; inaccurate enrollment projections; inefficient resource planning; loss of reputation; and non-compliance with legal and compliance requirements.

Internal Audit Strategy:

To evaluate and assess the effectiveness and efficiency of the student enrollment process within the District. Areas of our scope may include reviewing policies and procedures for student enrollment, evaluating the completeness and accuracy of student enrollment records, evaluating procedures for students with special enrollments, performing data analytics on the timeliness of enrollment processes, and reviewing controls in place to maintain accurate and reliable data.



ADDITIONAL IDENTIFIED HIGH-RISK AUDIT AREAS – CONTINUED

20. Purchasing Services – Contract Negotiation

Contracting is the process by which the District enters into agreements with vendors or suppliers to acquire goods or services. The District can acquire essential resources such as classroom supplies or maintenance services by entering into vendor contracts. A contract is formed when an authorized HISD representative(s) signs the Execution of Offer form. These contracts outline both parties' terms, conditions, and obligations, ensuring transparency, efficiency, and compliance with legal requirements. Negotiating with vendors involves engaging in discussions to secure favorable terms and conditions that align with the District's needs and budget constraints. The evaluation of terms and conditions includes thoroughly assessing contractual elements such as pricing, delivery schedules, performance metrics, and compliance requirements to maintain compliance with regulatory standards. An effective contracting process helps maintain operational continuity across the District while promoting a safe and transparent process.

Inherent Risks:

Outdated, inadequate, or undocumented policies and procedures; inadequate segregation of duties; non-compliance and inconsistencies with policies and procedures; inappropriate approvals; and inadequate or incomplete contract documentation.

Internal Audit Strategy:

To evaluate and assess the internal controls relating to the District's contracting processes. Our approach would include evaluating the management, execution, and oversight of contracts with vendors by reviewing relevant policies and procedures, assessing the selection process, including competitive solicitation, and verifying the appropriate approvals are obtained.



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