Office of the City Auditor

To: Honorable Mayor and Members of the City Council

From: Ann-Marie Hogan, City Auditor

Subject: Leases Audit: Conflicting Directives Hinder Contract Oversight

RECOMMENDATION
Request the City Manager to report back during or before January 2010 on the implementation status of each of the City Auditor's recommendations in the attached report. Report back no later than every six months, thereafter, until all recommendations have been fully implemented.

SUMMARY
A performance audit was conducted to determine:

➢ Whether facility leases were properly initiated, tracked, recorded, and renewed or terminated.

➢ Whether monitoring of collection activities was effective and efficient, and payments and receipts were properly recorded.

Public Works, though making substantial progress in certain areas of lease management, is not performing many of the basic responsibilities assigned to them. Clear, formalized expectations regarding lease management responsibilities were lacking.

1. City facility lease oversight functions remain largely decentralized, even though there was a Council approved budget, a new employee classification to oversee the function, and a described plan to centralize the lease oversight functions.

2. City staff do not always comply with City rules and regulations because the City lacks clear guidelines and simple tools for effective lease management.

3. A complete inventory of City facility leases is not available. Existing spreadsheets lack key information needed for locating and monitoring leases, and some may not be properly authorized by executed contracts.

4. There are no performance measures or reports available to document expectations of and performance by the Real Property Administrator or departmental lease managers.

5. Neither total dollars spent on leases nor total dollars received from leases can be determined from available reports in the City's financial system, SunGard/HTE (FUND$).

6. City staff could not locate copies of two leases.

7. Payments for two facility leases for the same property were applied to the wrong purchase order.

8. The City does not have adequate software for contract management. Opportunities to use existing and planned software and other systems to enable better oversight of leases and other contracts are being overlooked.

9. Enhanced coordination between departments is needed to define the City's contract management needs and to identify appropriate system and software solutions.

FISCAL IMPACTS OF RECOMMENDATION
Estimated unbudgeted start-up costs for relevant IT initiatives in the IT Master Plan are $5,325,000: $5 million to improve the Financial Management system (FUND$), $250,000 to improve records management (Enterprise Content Management), and $75,000 to implement grants management software. If these efforts are not coordinated with citywide needs, the $5.3 million spent on these applications may not meet the needs of stakeholders.

Due to the lack of the Real Property Administrator involvement in lease negotiations and the lack of a facility lease inventory, the City cannot be assured it is paying, or collecting, the best rate, and it cannot be assured that it is not exposed to unnecessary and unplanned liabilities.

RATIONALE FOR RECOMMENDATION
Implementation of our recommendations will help the Facilities Management Division provide improved centralized property and facility lease management services for the City, and decrease the risk of additional unplanned costs.

CONTACT PERSON
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Attachments:
1: Leases Audit: Conflicting Directives Hinder Contract Oversight

City of Berkeley
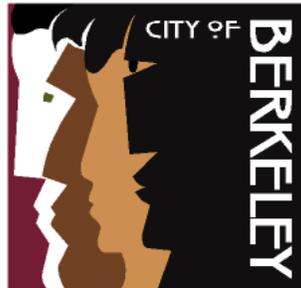
Leases Audit: Conflicting Directives Hinder Contract Oversight

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Presented to Council
June 2, 2009

Leases Audit: Conflicting Directives
Hinder Contract Oversight

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I. OBJECTIVE OF THE AUDIT

The objective for this audit was to determine the effectiveness of the City's facility lease oversight. To meet this objective we planned to assess:

➢ Whether facility leases were properly initiated, tracked, recorded, and renewed or terminated.
➢ Whether monitoring of collection activities was effective and efficient, and payments and receipts were properly recorded.

This performance audit was initiated by the Auditor's Office and scheduled as part of the FY 2009 Audit Plan presented to Council on June 24, 2008.

II. RESULTS

Deficiencies were identified in lease oversight in particular and contracts in general. The City has various types of contracts: for some, the City makes payments; for others, the City receives payments. City lease contracts fall under each of these categories.

> There is a disconnect between management's policies and procedures and actual staff practice.

Oversight of the City's leases has not been effective. Clear, formalized expectations regarding lease management are lacking. There is a striking disconnect between the City Manager's lease management policies and procedures and actual staff practice citywide. There are weak controls and missing information, as well as apparent inefficiencies.

Staff in various City departments do not comply with existing administrative regulations and other directives. Requirements for departments to promptly notify Public Works of planned lease activity, and to involve Public Works in all planned lease activity, are disregarded. Public Works, though making substantial progress in certain areas of lease management, is not performing many of the basic responsibilities assigned to them.

> Available resources are not aligned with performance expectations.

A failure to align the resources needed with the performance expected appears to have been a major factor undermining the City's ability to carry out planned oversight of leases.

Most documentation of expectations for the centralization of lease oversight appeared to be based on an assumption that several staff would be hired to assist the Real Property Administrator (RPA). In 2003 and 2004, Public Works appears to have sent two memos to the City Manager notifying him that they could not do the specified work in the job description for the RPA and in the Administrative Regulation (A.R.) for leases. However, in 2005, when the City Manager updated the A.R. regarding leases, no changes were made to reverse the centralization of responsibilities. As a result:

1. The City's facility lease oversight functions remain largely decentralized even though there was a Council approved budget, a new employee classification to oversee the function, and a described plan to centralize the lease oversight functions. (Finding 1)
2. City staff do not always comply with City rules and regulations because the City lacks clear guidelines and simple tools for effective lease management. (Finding 2)
3. There are no performance measures to document expectations of and performance by the RPA or departmental lease managers. (Finding 3)
4. A complete inventory of City facility leases is not available. Existing spreadsheets lack key information needed for locating and monitoring the leases and some leases may not be properly authorized by executed contracts. (Finding 4)
5. Neither total dollars spent on leases nor total dollars received from leases can be determined from available reports in the City's financial system, SunGard/HTE (FUND$). (Finding 5)
6. City staff could not locate copies of two leases. (Finding 6)
7. Payments for two facility leases for the same property were applied to the wrong purchase order. (Finding 7)

It is difficult to fully address concerns tied to lease contracts without recognizing the concerns with general citywide contracts.

8. Although the City does not have adequate software for contract management, opportunities to use existing and planned software and other systems to enable better oversight of leases and other contracts are being overlooked. (Finding 8)
9. Enhanced coordination between departments to capture various elements of a contract is needed to identify appropriate system and software solutions. (Finding 9)

Accomplishments noted by Public Works since hiring lease management staff in 2004 include:

> Sold property at 2344 6th Street for $2.2 million.
> Leased 100% of the spaces at the Telegraph & Channing Sather Gate Mall.
> Located property and successfully negotiated the lease for the new Police Substation.
> Auctioned residential property that resulted in higher sales price than expected.
> Assisted in acquisition and negotiations related to the development of the Hills Fire Station.
> Compiled a booklet of the City of Berkeley's real property.
> Assisted the City in negotiating a reduced fee from $500,000 to $5,000 for a land parcel used in the construction of the pedestrian walk-way: The City had received an invoice for land it believed it was "given" to connect the west portion of the pedestrian walkway to land.

III. BACKGROUND

In FY 2002, the City planned to move from a decentralized lease management system to a centralized lease management system.

The City owns buildings and facilities valued at over $100 million (net of depreciation).[1] A 2001[2] report stated that the City has over 100 City-owned properties including Library and Housing Authority properties. The report also stated the City leases 9 of its properties to other entities and leased 15 properties from other entities[3]. At the time of the report, deferred maintenance on City-owned facilities was estimated at over $25 million.[4] Reliable and up-to-date information on the current number of properties that the City is leasing from others was not provided to the auditors. Consolidated information on the costs of these leases was also unavailable.

According to the City Manager's Administrative Regulation 6.6 *Real Estate Transactions: Negotiating and Preparing City Lease or License Agreements, Acquiring/or Disposing of Real Property,* last updated in 2005, the Public Works Department is responsible for ensuring that all real estate lease agreements and amendments, and all real estate acquisitions and or disposals, are established according to City rules and regulations.

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[1] City's 2008 Comprehensive Annual Financial Report (CAFR).
[2] Public Works 2001 report, *Facilities Maintenance & Repairs Budget and Management Plan*.
[3] These included some temporary leases for City operations during the time that 2180 Milvia Street was seismically upgraded.
[4] Public Works 2001 report, *Facilities Maintenance & Repairs Budget and Management Plan*.

In FY 2002, the City planned to move from a decentralized lease management system to a centralized lease management system. Council voted to approve establishing a Real Property Administrator (RPA) position, charged with:

➢ All leasing, acquisition, and disposal of real property;
➢ All real estate appraisal and valuation services;
➢ All real property negotiations and contract administration;
➢ All property and asset management functions and property inventory; and
➢ Arranging for and maintaining necessary property insurance.

IV. FINDINGS AND RECOMMENDATIONS

Finding 1:   The City's 2002 plan to centralize property and facility lease management has not been implemented.

The City's 2002 plan to develop centralized property and facility lease management services has not been executed. City lease management functions remain largely decentralized in spite of management's direction to centralize them. There is a severe disconnect between what appears to be management's intent to centralize lease management services, and citywide actual practice.

> Lease management functions remain largely decentralized in spite of management's direction to centralize them.

The new Real Property Administrator (RPA) position was established after Council approval in 2002. A primary responsibility of this classification was to create a property management plan that outlines a phase in process to absorb the responsibilities to be transferred from other departments to the RPA. This plan was never completed.

The RPA was assigned to the Facilities Management Division of Public Works. A report dated February 4, 2002, estimated that 28 individuals performed duties related to lease management. The estimated time spent performing those duties was equivalent to five, full-time employees. According to the report, the RPA was to "supplement property and lease management activities currently dispersed over the five positions in several departments."

Limited Assistance Provided by the RPA

Correspondence provided by Public Works suggests that the number of staff needed to provide centralized lease management might have been discussed with the City Manager. An August 2002 memo to the former City Manager discusses the transfer of leases for the Berkeley Marina and for city-owned Sather Gate Mall properties. The memo states that this transfer of responsibilities "is based on the assumption that a new person will be assigned to take on some of these duties" and mentions what can be done "while we wait for the new person to come on board."

The FY 2003 budget adopted by Council added only one employee and $80,000 to the Public Works budget to "administer and ensure compliance with leases of city-owned facilities."

A memo from the RPA to the City Manager in February 2003 says, "the pressure on the unit to provide services has resulted in an internal policy decision to limit the amount of assistance provided." The memo appears to say that Public Works will take on management of the Marina leases and 1947 Center Street, but will otherwise only "provide minimal assistance to other departments" and take on "a limited number of other high priority projects for the City."

This memo indicates that the RPA would no longer be responsible for the negotiation of all City leases. However, the memo does not address the other tasks assigned to Public Works, such as development and maintenance of a complete inventory of both revenue and expenditure leases, and handling insurance for all City leases.

The 2003 decision by Public Works to get involved in negotiation and oversight of leases "only if requested" was not formalized. City procedures state that lease oversight is still centralized in Public Works. In fact, two years later, the City Manager re-issued Administrative Regulation 6.6 regarding leases. The regulation continued to state that all lease negotiations were to be undertaken by Public Works.

Recommendations for the City Manager and Public Works

1.1   The City Manager should formalize and approve the division of responsibilities between the Public Works department and other departments regarding lease management.

1.2   The Public Works department should determine and formally define the role of the real property administration staff given available resources.

City Manager's Response

The City Manager and Public Works Department agree with the finding and the recommendations. Recommendation 1.1 will be fully implemented by March 31, 2010. Recommendation 1.2 will be fully implemented by June 30, 2010.

Recommendations for Public Works

1.3 Develop and finalize a property management plan that documents the specific responsibilities of Public Works and of other departments for lease management.

1.4 The property management plan should be coordinated with affected City departments, including the Contract Administrator in Finance/Purchasing, before finalizing.

City Manager's Response

The Public Works Department agrees with the finding and the recommendations. The recommendations will be fully implemented by June 30, 2010.

Recommendation for the City Manager

1.5 Formally communicate the plan with all affected City departments.

City Manager's Response

The City Manager agrees with the finding and the recommendation. The recommendation will be fully implemented by June 30, 2010.

Finding 2: City staff did not comply with City rules and regulations because the City lacks clear guidelines and simple tools for effective lease negotiations, review, approval, and oversight.

City departments' staff did not always notify the Real Property Administrator (RPA) that leases were in negotiations or needed. This appears to be because existing guidelines are out of date. Simple tools are not available to help ensure compliance with City lease management requirements.

Staff citywide frequently disregard requirements for departments to notify and involve Public Works in planned lease activity. Notification of the RPA is sometimes made as an after thought, too late for involvement in the negotiation process, or as an "urgent request" for assistance at the last minute, according to Public Works. This appears to be because existing guidelines are out of date not only because they have not been updated for current practice in Public Works, but also because they have not been updated to reflect changes in the City's oversight and review of all contracts (including leases).

Conflicting Directives

The Contract Administrator in Finance/Purchasing reviews contracts and maintains an online contracts manual, available to City staff, with forms needed for contract review and execution. "Contracts Online" has very little information about leases, and some of its forms and provisions vary from the administrative regulation (A.R.) on leases.

The Contract Administrator has responsibilities for centralized contract insurance for all contracts, but the duties of the RPA include responsibility for insurance too, for lease contracts. The leases A.R. contains language that assigns the responsibility for insurance to the departments.

Another contradiction between the documented procedures and actual practice is that the review forms for contracts state that an extra original signed copy of every lease is to be routed for signature, and then forwarded to the City Clerk for distribution to Public Works. Although the RPA states that some project managers send her copies, extra copies of leases are not consistently being routed to Public Works. However, now that copies of contracts are online,[5] the RPA should consider whether she still needs to receive hard copies.

Simple Tools Not Used

Simple tools for lease management are not being used. A number of steps are needed to review leases. As easy as they are to complete, they are equally as easy to forget. A checklist is a simple, inexpensive tool that helps ensure small steps are not overlooked. If things are done right the first time, less time and money is spent on errors in the future.

> Conflicting directives resulted in staff confusion.

> A simple tool, like a checklist, could be used as part of internal controls to ensure small steps are not overlooked.

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[5] "Records Online" is the City's new online web tool that allows an Internet user to search and access City documents, such as contracts and Council minutes. Records Online can be accessed at http://www.ci.berkeley.ca.us/ContentDisplay.aspx?id=4222

An article in the *Washington Post* about using checklists in the surgery room noted that "the human brain can't remember everything, so it's best to focus on the complicated challenges and leave the simple reminders to a cheat sheet."[6] Developing a detailed checklist to help facilitate lease oversight can help the City reduce the time spent on lease oversight and prevent costly mistakes.

If management does not clarify guidelines, there is a high probability that City staff will continue to inconsistently adhere to the City's policies and procedures over lease management. This will result in increased difficulty in the City's ability to effectively manage, monitor, and safeguard its assets.

Recommendations for Public Works and Finance

2.1   Administrative Regulation 6.6 and Contracts Online should be updated to give clear direction to City staff regarding administration and execution of lease agreements.

2.2   The RPA should work with the Contracts Administrator to determine whether the RPA should be one of the reviewers of leases, and whether the RPA should receive copies of leases or be notified when they are posted online. They should also ensure that Contracts Online and related forms include all appropriate information for the execution of leases.

City Manager's Response

The Public Works and Finance Departments agree with the finding and the recommendations. The recommendations will be fully implemented by March 31, 2010.

Recommendation for Public Works

2.3   Simple tools like checklists and tickler systems should be developed to facilitate citywide compliance with lease oversight.

City Manager's Response

The Public Works Department agrees with the finding and the recommendation.   An interim checklist will be implemented by September 30, 2009, with final on March 31, 2010.

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[6] Ceci Connolly, (2009, January 15). "Surgery Checklist Lowers Death Rate." *Washington Post.* Retrieved January 21, 2009 from http://www.washingtonpost.com/wp-dyn/content/article/2009/01/14/AR2009011402831_pf.html

Finding 3:   There are no performance measures to document expectations of and performance by the Real Property Administrator or departmental lease managers.

The City lacks clear guidelines and expectations regarding lease oversight. The City's procedures and administrative regulations are not updated. There are no performance measures for the facilities lease management unit or for departmental lease management as it relates to lease oversight.

Performance measures can help ensure that resources needed are properly aligned with expected, and actual, performance by staff. Input measures such as budgeted and actual staff time used for negotiating leases versus giving advice to others should be considered. Outcome measures, such as revenues increased or expenses avoided should be established.

As discussed in Finding 1, there is a disconnect between what appears to be management's intent to centralize lease management and citywide actual practice. As resources become scarcer and management's priorities change, expectations regarding the roles of the Contracts Administrator in Finance, the City Attorney in the City Attorney's Office, the RPA in Public Works, and the project managers in departments must be clearly communicated. Much of this can be done through effective performance measures.

If management does not clarify the expectations of facility lease management oversight, informal decisions will be made and acted upon without management's knowledge or consent. The impacts of these informal decisions may not be fully disclosed and could result in the City unknowingly taking on greater risk. The impact may be invisible in the short term, but could eventually surface as an unacceptable risk for the City.

Recommendations for Public Works

3.1   Public Works should establish written performance measures for the Real Property Administrator that specify management's expectations of lease oversight. Performance measures should be challenging, take into account the available resources, and be attainable and affordable. Performance measures should also be monitored and periodically reassessed to ensure they are relevant and continue to meet the needs of the organization.

> Performance measures could be used to enable management to track the status of its budgeted initiatives.

3.2   Performance measure results, such as FTEs budgeted and used, timeliness of notification to and from departments, and measurable outcomes of efforts, should be reported, in writing, to the Department Director, quarterly. Consider providing a summary of this information to the City Manager, annually.

3.3   Public Works should update the City's real property administration policies and procedures to align with management's expectations.

City Manager's Response

The Public Works Department agrees with the finding and the recommendations. The recommendations will be fully implemented by March 31, 2010.

Recommendations for the City Manger and Public Works

3.4   The RPA, in accordance with the approved administrative regulation, should establish lease performance expectations for the departments and provide a written report to the Director of Public Works on a quarterly basis. If there are difficulties obtaining information, the Department Director should alert the City Manager.

City Manager's Response

The City Manager and the Public Works Department agree with the finding and the recommendation. The recommendation will be fully implemented by June 30, 2010.

Finding 4:   A complete inventory of City facility leases with key information is not available; it is not known whether all current leases are properly authorized by executed contracts.

The City does not have a complete inventory of City facility leases, and the existing lease-related spreadsheets lack key information needed to efficiently locate and monitor City leases.

Public Works is responsible for maintaining accurate and up-to-date information about what leases exist and what leases need to be negotiated. The City Manager affirmed that Public Works' authority is defined in A.R. 6.6.

The RPA identified property owned by the City by reviewing County records. However, she was not able to identify all information regarding the various City leases. To help identify new or amended leases, the RPA reads the Council Agendas and relies on contacts from other City departments.

On June 3, 2004, in an effort to establish a comprehensive City property inventory, the City Manager sent two memoranda to Department Directors requesting that they provide updated information regarding leases attributable to their departments. The information provided by the departments did not identify all City leases. Pertinent information such as effective dates, termination dates, fees, insurance expirations, inspection reports, and other provisions was also lacking.

> Inventory spreadsheets contained conflicting information.

Several property inventory spreadsheets contained conflicting information. In some cases the spreadsheet contained facility leases that had expired. In all cases the data collected did not include sufficient detail and key information. None of the spreadsheets included contract numbers for the leases, so it could not be easily verified that all leases were properly executed and, in fact, active. Using existing systems such as Records Online and the Contract Management System, some of this information could be updated.

Having a complete and accurate inventory of City leases with relevant, reliable information is a critical management tool for the effective monitoring and managing of City leases.

Recommendations for Public Works

4.1   Public Works should determine what information is needed in a centralized repository of lease information. Staff in the operating departments responsible for leases should be consulted to identify information that they need for monitoring leases. This information should be included in the centralized repository of lease information.

4.2   Public Works should obtain information from Purchasing, Accounts Payable, and the City Clerk about the citywide systems where lease management information is already available (see Finding 8). Property management staff should consider researching the data from existing sources or work with other City departments to generate a complete citywide inventory of facility revenue and expenditure leases.

4.3   Public Works should ensure that relevant detailed information such as contract numbers, annual cost of living adjustments, and other lease terms, fees, covenants, and locations are included in the complete lease inventory detail.

4.4   Public Works should make the lease inventory detail available to City staff so they can utilize the information to make informed decisions. If possible, this information should be available online in a format that allows controlled updates of information.

City Manager's Response

Public Works agrees with the finding and recommendations. In the interim Public Works will compile a lease inventory for all of the properties managed under Public Works including detailed information such as contract numbers, annual cost of living adjustments, and other lease terms, fees, covenants and locations. In addition, the interim list will include other obtainable lease information from other city departments. Public Works will work with IT to make this information available online in a format that allows controlled updates of information, if possible.

Recommendations will be partially implemented by September 30, 2009 and fully implemented by November 30, 2010.

Finding 5:   Neither total dollars spent on nor total dollars received from leases can be determined from reports in the City's financial system, SunGard/HTE (FUND$).

According to Finance staff, the City's financial system (FUND$) does not have the function set up to readily identify and report total lease revenues and total lease expenditures, nor the supporting detail. One reason for this appears to be inconsistent use of account strings that identify either facility lease revenues or expenditures.

The inability to easily present these financial monitoring reports limits the City's ability to correctly identify costs and revenue streams, which in turn could lead to unnecessary expenditures or lost income. It also prevents management from having accurate, reliable data for sound decision making.

Recommendations for Finance

5.1   Meet with departments to determine the most appropriate account code to record revenues and expenditures related to facility leases.

5.2   Set up the function in FUND$ that can report citywide facility lease revenue and expenditures totals. These reports should include the detail supporting the totals, e.g., property location.

City Manager's Response

The Finance Department agrees with the finding and the recommendations. Recommendation 5.1 has been fully implemented and recommendation 5.2 will be fully implemented by January 31, 2010.

Finding 6:   City staff could not locate copies of two leases.

The City has two active leases for the use of City-owned parking spaces at two separate locations. Inquiry was made to locate the lease agreements or other source documents that support the billings, which were identified as "general leases" in Miscellaneous Receivables module of FUND$ (the City's financial management system). City staff was not able to identify or retrieve the documents.

It appears the City has been receiving $175 for one lease for the past 15 years, and $360 for the second lease for the past 3 years. According to Finance, the customer and charges associated with the account were established in the billing system in October 1993 and they have no documentation to support the billing. According to Planning staff, there is no database that allows them to go back in time to review previous permits.

Without the lease agreements or supporting documentation the City can't identify or track critical information involving the terms of the agreements and can't effectively monitor the agreements to ensure compliance.

Recommendation for Public Works

6.1   Locate the missing agreements or supporting documentation. If the agreements or supporting documentation can't be located, consider working with Legal and the tenant to determine the best way to document the current terms of the leases.

City Manager's Response

The Public Works Department agrees with the finding and the recommendation. The recommendation will be fully implemented by June 30, 2010.

Finding 7:   Payments for two leases for the same property were applied to the wrong purchase order

The facility lease payments for contract #6461 and contract #7348 (for additional space at the same address) were not applied against the appropriate purchase orders. It appeared some of the payments were miscoded. Payout for both contracts for FY 2005 through FY 2008 totaled $402,791. Payments applied to the purchase order for contract #6461 were $27,500 less than the contracted amount. Payments applied to the purchase order for contract #7348 exceeded the contracted amount by $27,500. Fortunately, in this case, the net effect of the misapplied payments was zero. It does not appear that the City over- or underpaid the lessor.

Purchase orders are control mechanisms that help ensure a vendor is paid the proper amount for the approved service (or goods). When payments are applied to the incorrect purchase order, the City is unable to properly track the amount paid and the amount due to a vendor making it difficult to assess the appropriateness of the payments.

Recommendation for Finance and Health & Human Services

7.1   Make the necessary adjusting entries so that payments are applied to the correct purchase order.

City Manager's Response

The Finance and Health & Human Services Departments agree with the finding and the recommendation: alternative implemented. As of April 16, 2009, the payment errors have been documented in the purchasing module. Payments for Contracts #6461 and #7348 are now paid out of one purchase order.

Recommendation for Public Works and Health & Human Services

7.2   Consider amending the original lease to include the additional property. This will eliminate the need for two leases and two purchase orders for the same property.

City Manager's Response

The Public Works and Health & Human Services Departments agree with the finding and the recommendation: alternative implemented. The two leases will be combined in March 2010 when the terms of both leases expire.

Finding 8:   Opportunities to use existing and planned software and other systems to enable more effective oversight of leases and other contracts are being overlooked.

The Real Property Administrator (RPA) is not utilizing available tools and systems in place to perform lease oversight functions. It is difficult to address concerns over lease oversight without recognizing concerns impacting the oversight of other general contracts citywide. The City does not have an adequate citywide contract management system. Leases are a type of contract and are recorded in the citywide contract management system.

Contract Management System

Departments rely on a contract tracking system, called the Contract Management System (CMS), to determine whether or not their contract has been approved or where it is being held up.

| Can existing systems be used to perform needed tasks? |

CMS was developed in the early nineties to bring greater transparency to the contract routing system. It was designed to interface with the City's financial system, FUND$, but the interface does not appear to be working properly.[7]

In spite of these limitations, CMS can be used to locate information about contracts, including what date they were approved by Council, and when they were executed by the City Manager.

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[7] According to Information Technology staff, links to FUND$ data will only work when the requisite information has been provided for a contract. IT stated that users can view related general ledger (GM), purchasing (PI), business license (OL) and/or property (LM) information in CMS, but added that the problem with CMS is that the "link" fields are not required and IT is not able to easily make them required. As a result, the links often don't work.

Council items online: City Clerk

The City Clerk's Agenda Review Workflow system (ARWS) is a customized workflow process that is part of the City's Enterprise Content Management system (ECM). ARWS has an online review function designed to replace the manual review process of reports to City Council, including the ordinances required for initiation of all leases. The City Attorney's Office, the Budget Office, the City Clerk's Office, and the City Auditor's Office perform ARWS online reviews.

Documents online: City Clerk and Finance/Purchasing

The City Clerk was involved in another initiative that may have changed requirements and responsibilities regarding leases. In 2006, the Finance/Purchasing Contracts Administrator and the City Clerk sent a Notice of Interest (NOI) to Information Technology to automate the contracts management process.

Phase I of the proposal was a document imaging and indexing system for contracts. It would allow Finance/General Services to monitor the expiration of insurance certificates. It would also allow public online availability of all contract documents. Contracts executed over the last several years are now available for online viewing on the City Clerk's web page.[8]

The City has a number of initiatives underway that might involve replacing CMS with a system that helps staff effectively and efficiently manage and monitor contracts. However, there are concerns with the coordinated effort to meet the needs of various City departments (see Finding 9).

Recommendations for Public Works and Finance

8.1   Until new contract software is in place and a new AR developed, determine whether it would be effective to include Public Works as a reviewer for leases as part of either the City Clerk's agenda workflow system for Council items, or as part of Finance's manual contract review process system. Alternatively, consider improving the coordination between the City Attorney Office's review and the RPA's review.

8.2   The RPA should determine if the existing systems can be used to finalize a comprehensive list of existing City leases. (See Finding 4)

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[8] Records Online: http://www.ci.berkeley.ca.us/recordsonline/search.aspx

City Manager's Response

The Public Works Department agrees with the finding and the recommendations. The recommendations will be fully implemented by July 31, 2009.

Finding 9: Enhanced coordination between departments to capture various elements of a contract is needed to identify appropriate system and software solutions.

Many City departments are charged with initiating and monitoring expenditure contracts for goods and services, as well as revenue contracts for grants and leases. The departments use a variety of stand-alone systems and databases for contract management.

The City Manager's Budget Office reviews contracts to ensure that funds are available. The Contract Administrator in Finance/Purchasing reviews contracts to ensure that the City Manager has signed the contract and that there is proper authorization and adequate insurance, before transmission to the City Auditor for registration and to the City Clerk for distribution, storage, and online posting.

> Allocate planned, adequate resources to do it right the first time or risk having to use additional, unplanned resources to redo or correct it later.

Staff has to collect information from numerous City systems tracking various components of contracts**.** Grant managers currently use a variety of systems to track different components of a grant, including FUND$ codes, spreadsheets, and paper files. Also available are CMS, ARWS, and documents online (see Finding 8). Although these various systems can be used to help facilitate contract oversight, neither the City Clerk's system nor CMS includes all of the information needed to comprehensively manage grants and other contracts, such as leases. Lease contract features would include term limits, covenants, insurance updates, and payment history. IT suggests that grants accounting will be implemented with separate, specialized software.

Some of the information needed for grants management is the same as that needed for lease inventory and management. Desirable features include: Tickler systems to be used, for example, for insurance renewals, whether managed centrally or departmentally by project managers; expenditures to date on a purchasing contract so that Finance Accounts Payable is not relying on index cards to approve payments; electronic routing and approval of contracts documents; identification of budgets and expenses so that grant expenditures eligible for billing, actual expenses and billed expenses, and projected shortfalls can be monitored systematically and timely.

The City's *Information Technology Master Plan* includes several strategies and action items relevant to contracts management problems. The projects include the Enterprise Content Management system, "an evolving strategy for managing, storing and delivering public records." It lists as an action item "Begin contract process improvement needs analysis…." Financial Management (FUND$) is aimed at "better alignment of financial software with business needs and strategic goals."

A needs analysis for citywide contract management is currently not funded. A lack of effectively coordinated interdepartmental planning to address the City's initiatives dealing with the City's contract management problems could cause key features to be ignored and critical aspects of an effective contract management system to be overlooked. This could ultimately result in the need for costly upgrades or modifications to a new system. This could be a concern if efforts to improve grants are not coordinated with efforts to improve expenditure contract management. Finance/Accounting is lead on grants oversight and Finance/Purchasing on all contract review. In recognition of the City Manager's statement that improving contract management systems is not feasible at this time, we recommend an approach that at least includes all of Finance's contract responsibilities.

Recommendations for Finance and Information Technology

9.1   Finance, in coordination with Information Technology, should determine what information is needed by Finance staff responsible for citywide contract oversight, primarily Purchasing and Grants Accounting. Ensure that any planned software solution(s) for contracts address these needs. If separate, stand-alone systems are determined to be the best way to manage leases, grants, and other contracts, ensure that the systems are compatible with each other and other applications used by the City, such as FUND$.

City Manager's Response

The Finance and Information Technology Departments agree with the finding and the recommendations. The recommendations will be fully implemented by March 31, 2010.

V. FISCAL IMPACT

$5,325,000 should be used wisely.

Estimated start-up costs for the IT initiatives that appear related to contract management systems identified in Finding 9 are $5,325,000.[9] If these efforts are not coordinated with citywide needs, the $5 million spent on these applications may not meet the needs of the stakeholders. Sufficient resources and well coordinated up-front planning is needed, if these software projects are going to succeed.

The inefficiencies associated with lease management, as well as contract management in general, are costing the City money it does not have to spend. When the Real Property Administrator is not involved in lease negotiations, the City cannot be assured it is paying, or collecting, the best rate.

Poor internal controls and inefficiencies have negative economic consequences.

Without an inventory or appropriate tracking system, contracts or insurance may expire without anyone's knowledge. This exposes the City to unnecessary and unplanned liabilities, such as possible litigation. It also means that the City could be paying a lease fee much higher than fair market, or charging a lease fee well under fair market.

VI. CONCLUSION

There is a severe disconnect between what appears to be management's intent to centralize lease management and citywide actual practice. Key concerns include not developing a written plan to phase in the transfer of existing property management responsibilities to the Real Property Administrator and move from a decentralized to a centralized lease management system; not developing clear guidelines, expectations, or performance measures for the facilities lease management unit or other departmental lease managers citywide; and not identifying and developing a complete inventory list of City facility leases. Additional concerns include missing documentation and miscoded payments.

Also identified were inefficiencies with the development and use of existing and planned software. There could be opportunities to use existing software and other systems to more effectively manage lease oversight.

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[9] This includes unbudgeted cost estimates for the following initiatives: Enterprise Content Management, $250,000; Financial Management, $5,000,000; and Finance Grants Management, $75,000.

It is difficult to address concerns over lease contracts without recognizing the limitations in executing effective and efficient oversight of all citywide contracts. The current efforts to develop a needs analysis for citywide contracts management software solutions could be better coordinated among the various City departments. A result of ineffective coordination and poor planning is the increased risk of additional, unplanned "costs for corrections" when a project is not done right the first time.

Until these weaknesses are corrected, the Facilities Management Division will continue to fall short of its mission to provide effective centralized property and facility lease management services for the City.

We want to thank the Director of Public Works and the Real Property Administrator for their cooperation during this audit.

APPENDIX A

<u>SCOPE AND METHODOLOGY</u>

We performed preliminary survey and fieldwork between June 2008 and August 2008. This included the examination of eight City lease agreements, as well as interviews and discussions with City staff involved with lease management. We asked basic questions about internal controls and common practices affecting lease oversight. We also reviewed the Real Property Administrator and Facilities Management Division's practices over lease management and compared those practices against administrative regulations and budgeted objectives of the City. The results of our examinations, reviews, interviews, and communications are the basis for the findings in this report.

An evident lack of clear, formalized expectations regarding lease management responsibilities led us to conclude that additional audit work should not be performed until roles and responsibilities were clarified. Accordingly, we did not continue efforts to comprehensively meet our planned objective. We did identify the numerous concerns with the effectiveness and efficiency of lease management, which are included in this report.

We conducted this performance audit in accordance with *Generally Accepted Government Auditing Standards (GAGAS)*. Those standards require that we plan and perform our audit to obtain sufficient and appropriate evidence that provides a reasonable basis for our findings and conclusions, based on our audit objectives. We believe that the evidence obtained provides reasonable basis for our findings and conclusions, based on our audit objectives.

Section 2.24.050 of the Berkeley Municipal Code requires the City Auditor to review, countersign, number, and register all City contracts. This review process includes checking information input in the Contract Management System (CMS) by City departments. We believe that this function did not impact our ability to remain independent according to GAGAS as stated above.

<u>DATA RELIABILITY</u>

We did not rely on computer-processed data for the basis of findings, recommendations, or conclusions in this report; therefore, we did not test the controls over the validity and reliability of the data.