



Office of the City Auditor

INFORMATION CALENDAR

May 31, 2011

To: Honorable Mayor and Members of the City Council  
From: Ann-Marie Hogan, City Auditor  
Subject: City Auditor's Annual Report for Fiscal Year 2010

SUMMARY

In 2010, we succeeded in our mission to improve performance of City operations, save money, and promote transparency and accountability. The City Manager and City staff helped us achieve this by agreeing to take action on 99 percent of the 92 recommendations we made in our audit reports.

FISCAL IMPACTS OF RECOMMENDATION

Our audits and consulting work provide practical advice and clear direction for more efficient and effective service delivery. In fiscal year 2010, we identified opportunities for cost savings and recovered revenue of nearly \$531,000 (\$370,000 recurring). Over a five-year period, the results could exceed \$2 million.

CURRENT SITUATION AND ITS EFFECTS

We continued our emphasis on Public Works by conducting an audit of sewer-line work. We found that the City has too many sewer spills, many of which are preventable. In 2010, we also experienced a first: Housing received our only audit report to date with no findings and no recommendations. Housing successfully established procedures to help meet Recovery Act requirements. A common theme appeared in our other 2010 audits. We found that our auditees were not adequately performing critical monitoring functions. This put the City at risk of lost revenues and overpayments. It also put some of the City's most vulnerable citizens at risk.

We continued our practice of issuing essential policy reports to Council related to budget cuts, staff and revenue reductions, and outstanding audit recommendations. Although implementation rates were up, several remain outstanding, two of which are over a decade old. As the City continues to face a budget crisis, we expressed our concern over cutting oversight and administrative positions. It is an elementary principle of budgeting that assigning a certain percentage of total costs for oversight and administration is not realistic when overall budgets change. The workload of staff who perform these tasks does not decrease with the shrinking of available funds.

### **Policy Reports**

- [Investing in Long Term Cost Savings: Workers' Compensation and Wellness](#)
- [Fiscal Responsibility and Outstanding Audits: Policies, Problems, and Solutions](#)
- [City Auditor's Proposed Budget Cuts FY 2011](#)

### **Audit Reports**

- [Utilization of Public Works Sewer Staff Can Be Improved](#)
- [Recovery Act Readiness: Housing Is Prepared to Meet Funding Requirements](#)
- [Mental Health Adult Clinic Surprise Cash Count: Client Funds Could Be Lost, Stolen, or Misused](#)
- [Improved Workflow Systems will Help Ensure Property Taxes Are Adjusted for New Construction](#)
- [Public Works Contract Monitoring: Risk of Overpayments / Lack of Inventory Controls](#)
- [Over \\$38,000 in Duplicate and Overpayments Recovered](#)
- [Business License Tax Program Fiscal Year 2009](#)

### **BACKGROUND**

The City Auditor's Office mission is to provide independent oversight of City operations and to be a catalyst for improving City government. Through our recommendations, we provide the Council, City management, and staff with practical advice to protect the City's interests, and with clear direction to achieve City goals.

### **CONTACT PERSON**

Ann-Marie Hogan, City Auditor, Office of the City Auditor, 981-6750

Attachment:

1. City Auditor's Annual Report for Fiscal Year 2010

# City of Berkeley



## City Auditor's Annual Report Fiscal Year 2010

Prepared by:

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Presented to Council on May 31, 2011

# City Auditor’s Annual Report for Fiscal Year 2010

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## City Auditor's Message

The City Auditor's reports give me more trust and confidence in what City government is doing.

- Berkeley Resident

In 2010, we succeeded in our mission to improve performance of City operations, save money, and promote transparency and accountability. The City Manager and City staff helped us achieve this by agreeing to take action on 99 percent of the 92 recommendations we made in our audit reports.

An auditor's role is important. Our independent oversight and impartial analyses contribute to operational and fiscal impacts that benefit the residents of Berkeley over the long-term. Through our recommendations, we provide the Council, City management, and staff with practical advice to protect the City's interests, and with clear direction to achieve City goals.

We congratulate the Housing Department for receiving our first audit report with no findings and recommendations. We thank the employees, managers and Councilmembers for recognizing the benefits of our recommendations and taking the steps necessary to ensure they are implemented. We also thank the residents of Berkeley for bringing us their ideas on how to improve City services. Through these collaborative efforts, we've demonstrated our continued commitment to making Berkeley a great place to live and work.

## 2010 Reports

### The Housing Department Makes History

First City Auditor report with no findings and no recommendations.

Recovery Act Readiness: Housing Is Prepared to Meet Funding Requirements (April 20, 2010) – Housing appeared prepared to meet Recovery Act requirements. It established procedures to accurately capture all data needed to report revenue, expenditures, and jobs created under each Recovery Act grant. As of April 2010, the Department was responsible for six

Recovery Act grants totaling over \$3.3 million.

### Berkeley Has too Many Sewer Spills and Many of Them Are Preventable

Berkeley has a high number of sewer spills – 20% of repeat spills are preventable.

Utilization of Public Works Sewer Staff Can Be Improved (October 13, 2009: 86 percent of 35 recommendations reported fully implemented as of 4/30/11) – The City's high spill rate, and especially its high repeat rate, indicates that improvements in planning and performance are needed. The Department of Public Works needs to plan sewer line maintenance more effectively to reduce the risk of overflows and fines. With improved monitoring

and supervision, Public Works management can target problems, save money, and help save the bay.

## Safeguarding Client Funds and Information Maintains Public Trust

There is inherent risk in handling other people's money.

Mental Health Adult Clinic Surprise Cash Count: Client Funds Could Be Lost, Stolen, or Misused (December 15, 2009: 50 percent of six recommendations reported fully implemented as of 4/30/11) – The clinic's poor record keeping prevented us from completing the surprise cash count. The Department of Health Services was unable to provide evidence that all client cash was present and accounted for at the time of our site visit. The department lacked adequate procedures to safeguard client funds and needs to strengthen its procedures to protect client information.

## Maximizing Property Tax Revenue: It Takes Two

Many City taxes are based on building square footage – new construction provides new funding for City services.

Improved Workflow Systems Will Help Ensure Property Taxes Are Adjusted for New Construction (December 15, 2009: 88 percent of 16 recommendations reported fully implemented as of 4/30/11) – Finance and Planning need effective workflow systems to ensure that property taxes are adjusted to account for new construction. The departments have some systems in place, but improvements in coordination, communication, and accountability are needed.

## Contract Monitoring is Critical to Ensuring Contract Performance and Pricing

Public Works took immediate action to improve contract monitoring.

Public Works Contract Monitoring: Risk of Overpayments / Lack of Inventory Controls (February 9, 2010: 87 percent of 23 recommendations reported fully implemented as of 4/30/11) – The Department of Public Works needs to effectively monitor contract compliance. Due to lack of monitoring, the department did not identify or correct several billing errors. The department must clarify contract terms and conditions, require supporting documentation for administrative costs, and develop written procedures. Monitoring was burdensome and inefficient for one contract because of its complex and unclear expectations.

## Finance's Internal Controls Reduced the City's Exposure to Duplicate Payments

Bypassed polices, not fraud, resulted in duplicate and over-payments.

Over \$38,000 in Duplicate and Overpayments Recovered (February 9, 2010: 42 percent of 12 recommendations fully implemented as of 4/30/11) – Finance's procedures have helped reduce the City's exposure to duplicate payments. Some experts estimate that 0.5<sup>1</sup> percent to 2 percent<sup>2</sup> of an organization's disbursements are duplicate payments. By contrast, the City's duplicate payments represent only 0.03 percent of the City's fiscal year 2009 accounts payable expenditures.

<sup>1</sup> Mike Blakely, "Testing for Duplicate Payments," (retrieved online April 2011), [http://ezrstats.com/doc/Testing\\_for\\_Duplicate\\_Payments.pdf](http://ezrstats.com/doc/Testing_for_Duplicate_Payments.pdf)

<sup>2</sup> Van Holsbeck, Mark and Johnson, Jeffrey Z. "Security in an ERP World" (May 2004), [www.net-security.org/article.php?id=691](http://www.net-security.org/article.php?id=691)

**Long-Standing Practice of Recovering Money Continues**

Recovered BLT money contributes to annual revenues indefinitely.

Business License Tax Program Audit Report for Fiscal Year 2009 (February 9, 2010) – The Auditor's Office billed approximately \$138,000 in business license tax, penalties, and interest in fiscal year 2009, and \$144,000 in fiscal year 2010. This is a recurring source of revenue, since the audited businesses will continue to pay taxes in the future. From 1982 through 2010, auditors not only billed taxes, penalties, and interest totaling over \$5.2 million, but also contributed to a permanent increase in annual revenues.

**Cost Savings or Revenue Recovery of Over \$0.5 Million in Year One and \$2 Million in Five Years**

Fiscal year 2010 audits identified opportunities for cost savings and recovered revenue of nearly \$531,000 (\$370,000 recurring). Over a five-year period, the results could exceed \$2 million:

Audit	1st Year	Recurring	Five Years
<u>Business License Tax Program Fiscal Year 2010</u>	\$144,000	\$21,000	\$226,000
<u>Over \$38,000 in Duplicate and Overpayments Recovered</u>	38,000	-	38,000
<u>Public Works Contract Monitoring: Risk of Overpayments / Lack of Inventory Controls</u>	62,000	62,000	310,000
<u>Improved Workflow Systems will Help Ensure Property Taxes Are Adjusted for New Construction</u>	17,000	17,000	85,000
<u>Utilization of Public Works Sewer Staff Can Be Improved</u>	270,000	270,000	1,350,000
<b>Totals</b>	<b>\$531,000</b>	<b>\$370,000</b>	<b>\$2,009,000</b>

**Transparency and Risk Reduction**

"A government's most precious commodity is its credibility."  
 - Jim Walsh, MIT Nuclear Reactor Subject Matter Expert

Berkeley's Charter gives the City Auditor a special role in reducing the risk of management override of internal controls by granting oversight of payroll and other payments. The City Auditor issues more than 50,000 biweekly payroll checks and direct deposits annually.

The Charter also requires the Auditor to countersign and register all contracts. We reviewed and registered 569 contracts and contract amendments in 2010. The City Clerk posted the contacts to Records Online at <http://www.ci.berkeley.ca.us/recordsonline/search.aspx>.

## City Auditor Takes a Long-Term View

### **Dangerous Cuts to Oversight – Managing the Risk**

During tough economic times, it is often fastest and easiest to cut expenditures in support areas. This hasty reaction can be costly, as it results in heightened risks from weakened internal controls. For example, when making decisions in an era of declining resources, there is a forced tradeoff between direct services and oversight, such as performance monitoring, auditing, and supervision.

"If you're losing altitude and your plane is going down, you don't try to shed weight by tearing out your instrument panel and throwing it out."

- Governing Magazine  
July 2010

If the City is typical, the cost of cutting oversight is far greater than the cost of funding oversight.

A well-functioning system of internal controls helps prevent service delivery shortfalls, costly inefficiencies, and fraud, waste, and abuse. A typical organization loses 5 percent of its annual revenues to fraud.<sup>3</sup> If applied to Berkeley's 2011 General Fund budget of \$146 million, the result would exceed \$7.3 million.

On October 9, 2007, we recommended, and Council voted to require departments, in the annual budget submission, to identify and quantify the risks of significant procedural weaknesses that have not been addressed due to insufficient resources or staff capabilities. In fiscal year 2010, we issued three policy reports to Council related to budget cuts, staff and revenue reductions, and outstanding audit recommendations:

1. Investing in Long Term Cost Savings: Workers' Compensation and Wellness (October 13, 2009)
2. Fiscal Responsibility and Outstanding Audits: Policies, Problems, and Solutions (January 26, 2010)
3. City Auditor's Proposed Budget Cuts FY 2011 (March 9, 2010)

On November 16, 2010, we published a report on underfunded liabilities (employee benefits). Council discussed the report in a special work session on January 18, 2011. Careful thought and analysis about the future consequences of today's decisions is critical to ensuring the City's long-term financial stability. This report demonstrates why cuts to oversight are dangerous.

<sup>3</sup> 2010 Report to the Nation on Occupational Fraud and Abuse.



## Audit Follow Up: Implementation Rate on the Rise

We are pleased to report that the recommendation implementation rate has improved this year. City departments continue to implement recommendations from prior years' audits. As of April 30, 2011, we closed 81 of the 137 recommendations reported as outstanding in our 2009 Annual Report. We have already closed 78 percent of the recommendations from our 2010 audits. The average implementation rate of our recommendations since 2005 is 86 percent, which compares favorably with the average rates of 77 percent and 82 percent achieved by other local government audit organizations<sup>4</sup> and the federal Government Accountability Office (GAO),<sup>5</sup> respectively.

We are also happy to report that our auditees' acceptance of audit recommendations continues to exceed the average acceptance rate of 94 percent achieved by other local government audit organizations. In fiscal year 2010, auditees accepted 99 percent of our audit recommendations.

### Audit Recommendations Fiscal Years 2005 through 2010

	2005	2006	2007	2008	2009	2010
Number of Audits	5	5	5	10	5	8
Number of Recommendations	65	48	55	63	67	92
Percent of New Recommendations Accepted by Auditee	98%	100%	93%	98%	99%	99%
Fully Implemented (closed)	62	41	49	60	48	72
<b>Percent Implemented</b>	<b>95%</b>	<b>85%</b>	<b>89%</b>	<b>95%</b>	<b>72%</b>	<b>78%</b>
Partially Implemented (open)	1	3	1	1	11	11
Not Implemented (open)	1	4	1	1	7	8
<b>Percent Open</b>	<b>3%</b>	<b>15%</b>	<b>4%</b>	<b>3%</b>	<b>27%</b>	<b>21%</b>
Will Not Implement (closed)	1	0	4	1	1	1
<b>Percent Will Not or Cannot Implement<sup>6</sup></b>	<b>2%</b>	<b>0%</b>	<b>7%</b>	<b>2%</b>	<b>1%</b>	<b>1%</b>

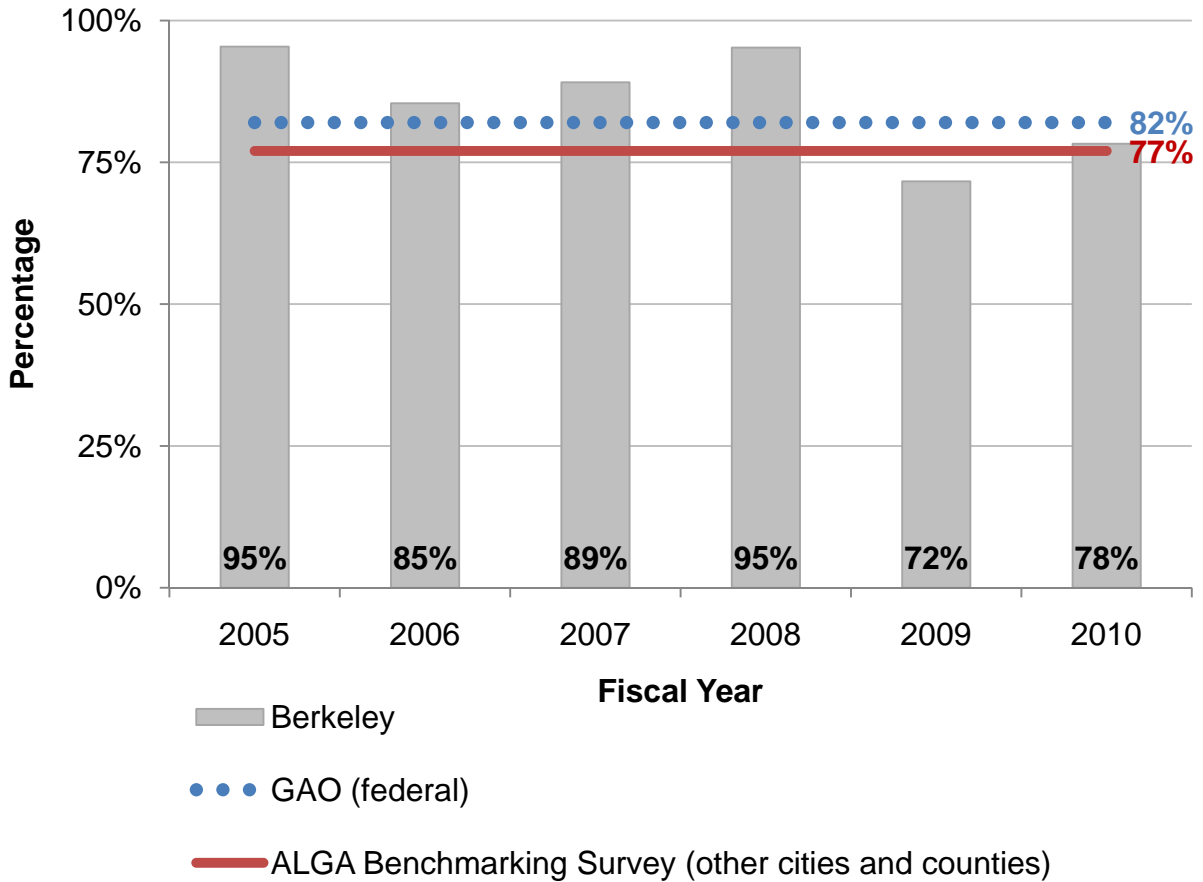
See [Appendix A](#) for more information on *open* recommendations dating back to 1998.

<sup>4</sup> Association of Local Government Auditors (ALGA), 2010 Benchmarking and Best Practices Survey, Table 12, page 11.

<sup>5</sup> U.S. Government Accountability Office – Fiscal Year 2010 Performance Plan, GAO-11-343SP, Table 3, page 6.

<sup>6</sup> Auditees are sometimes unable to implement a recommendation because they lack the resources. For example, staffing cuts to oversight positions may prevent an auditee from implementing recommendations aimed at improving internal controls.

### Recommendation Implementation Rates Compared to Other Audit Organizations (as of April 30, 2011)



### Who Are the Auditors?

Ann-Marie Hogan  
- City Auditor

Teresa Berkeley-Simmons\*  
- Audit Manager

Frank Marietti  
- Senior Auditor

Jack Gilley  
- Auditor II

Claudette Biemeret  
- Auditor II

Myrna Ortiz  
- Auditor I

Sherren Styles  
- Administrative Assistant

\*Teresa left the Auditor's Office in October 2010 to become the City's Budget Manager

City of Berkeley auditors have extensive knowledge of analytical methods and techniques. Collectively, we have more than 100 years of professional audit experience. We hold a variety of professional certifications, including Certified Internal Auditor, Certified Government Auditing Professional, and Certified Fraud Examiner. We maintain and improve our professional competence by participating in continuing professional education courses annually, as required by the Government Auditing Standards.

We also grow professionally by actively participating in local and national audit organizations. Our participation has included board and committee membership, publication in professional journals, presentations at audit conferences and the League of California Cities, and conducting peer reviews of other local government audit organizations.

Auditors from other local government audit organizations review our work every three years to ensure we continue to meet the requirements of the Government Auditing Standards. Those standards, which the City Charter requires we follow, provide a framework for conducting high quality audits with competence, integrity, objectivity, and independence.

### **The City Auditor's Office Mission**

The City Auditor's Office mission is to provide independent oversight of City operations and to be a catalyst for improving City government. Our audits provide the City Manager, City Council, departments, and the public with objective, timely, and accurate information about the performance of City programs. Our audits help make government more accountable and can lead to new revenue, cost recovery, and cost avoidance. Audits can increase efficiency and lead to improved program outcomes, which have an economic impact well beyond the audit costs. Our audits also ensure that departments have adequate procedures to prevent fraud, waste, and abuse. The City's support for and responsiveness to the audits helps build a more ethical and transparent culture, and builds public trust in the City.

We will continue to work to improve the ability of City staff to monitor the effective use of City resources, through our training, consulting, follow-up work, and performance audits. By providing reliable and objective information about City programs and services, we hope to enhance the ability of staff, City Council, and Berkeley residents to make informed decisions about performance, programs, and resources.

**Appendix A: Open<sup>7</sup> Recommendations as of April 30, 2011**

Council Direction: Budget	Fiscal Year	Open Recommendation
<u>Invisible Problems: Weak Internal Controls Require Disclosure by City Manager and Possible Future Council Action on Budget and Workplans</u>	2008	1

Report Title	Fiscal Year Issued	Total Recommendations	Total Open	Percent Open
<u>Public Works Grants Audit</u>	1998	8	1	13%
<u>City-wide Payroll Audit</u>	1999	45	2	4%
<u>Police Staffing Audit</u>	2002	11	3	27%
<u>Customer Service Cash Receipts / Cash Handling Audit</u>	2003	23	3	13%
<u>Cash Receipts / Cash Handling Audit - Treasury</u>	2003	19	1	5%
<u>FUND\$ Change Management Audit</u>	2004	23	5	22%
<u>Accounts Payable Audit</u>	2004	16	1	6%
<u>Purchase Order Audit - Select Public Works Divisions At the Corporation Yard</u>	2005	23	1	4%
<u>Parcel Based Special Taxes, Fees, and Assessments Audit</u>	2005	22	1	5%
<u>Audit of the Association of Sports Field Users</u>	2006	13	7	54%
<u>Follow-Up Audit of Public Works Construction Contracts</u>	2007	22	2	9%
<u>Audit of HHS Medi-Cal Mental Health Billings</u>	2008	2	1	50%
<u>FY 2008 Surprise Cash Count: Permit Service Center</u>	2008	5	1	20%
<u>Leases Audit: Conflicting Directives Hinder Contract Oversight</u>	2009	24	11	46%

<sup>7</sup> Open recommendations include those that are in progress and those that the auditee has not started to implement. It excludes recommendations that the auditee will not, or cannot, implement.

Report Title	Fiscal Year Issued	Total Recommendations	Total Open	Percent Open
<u>Audit of Workers' Compensation Policies and Procedures</u>	2009	26	7	27%
<u>Public Works Contract Monitoring: Risk of Overpayments / Lack of Inventory Controls</u>	2010	23	3	13%
<u>Over \$38,000 in Duplicate and Over Payments Recovered</u>	2010	12	7	58%
<u>Improved Workflow Systems Will Help Ensure Property Taxes are Adjusted for New Construction</u>	2010	16	1	6%
<u>Mental Health Adult Clinic Surprise Cash Count: Client Funds Could Be Lost, Stolen, or Misused</u>	2010	6	3	50%
<u>Utilization of Public Works Sewer Staff Can Be Improved</u>	2010	35	5	14%
<u>Audit: City Fuel Operations Need Improvement</u>	2011	15	14	93%
<u>Police Property and Evidence Room: Further Improvements</u>	2011	20	5	25%
<u>Property and Evidence Room POST Study: Follow-up Audit</u>	2011	1	1	100%
<u>Employee Benefits: Tough Decisions Ahead (Audit Report)</u>	2011	5	5	100%
<u>Lack of Support for Payroll Adjusting Journal Entries: Grant Revenue at Risk?</u>	2011	3	3	100%
<u>Equipment Replacement Fund - Sustainability and Transparency</u>	2011	16	16	100%
<u>Efficiency and Transparency of Contract Fiscal Management Needs Improvement</u>	2011	7	4	57%
<b>Total</b>		<b>441</b>	<b>114</b>	

The full text of each of these reports is available on the City Auditor's website: <http://www.cityofberkeley.info/auditor/>.

