



Office of the Auditor

ACTION CALENDAR

December 8, 2008

To: Honorable Mayor and Members of the City Council  
From: Ann-Marie Hogan, City Auditor  
Submitted by: Ann-Marie Hogan, City Auditor  
Subject: City Auditor's Presentation: Annual Report for Fiscal Year 2008

RECOMMENDATION

Accept City Auditor's Annual Report for Fiscal Year 2008

INTRODUCTION

Attached is the City Auditor's Annual Report for the fiscal year ending June 30, 2008. As a convenience to online readers, web links are included for each audit report identified. This Annual Report will be available on the City Auditor's website: [www.cityofberkeley.info/auditor](http://www.cityofberkeley.info/auditor)

SUMMARY

We report on the actions we recommended, what changed because of our audits, and how the City Manager addressed our findings. We discuss impacts of national and local economic and budgetary trends. We reiterate our longstanding concerns regarding the erosion of prudent fiscal controls as a result of budget cuts.

CURRENT SITUATION AND ITS EFFECTS

Last year, we continued our emphasis on public safety with audits of Police, Fire, and Health and Human Services. We found that response times to calls for emergency medical services could be improved. We recommended more patient-focused performance measures, as well as other systems and service improvements to make Berkeley's better-than-average response times even better. We identified improvements needed in accountability for Police Asset Forfeiture accounts, and in monitoring and inventory systems of Fire Department controlled substances. We found risks to future revenues in the Health and Human Services Department, Mental Health Division. Finally, similar findings in surprise cash count audits conducted at five locations this year indicate a citywide need to improve controls over cash handling. As a result of our audits, the City Auditor's staff developed over sixty recommendations that resulted in improved performance, reduced risk, and increased revenue.

This report once again reminds Council that the City's approach to handling budget cuts must include more thorough analysis and disclosure. Council is accepting significant

risks when voting to reduce the resources needed to maintain oversight and prevent fraud, abuse, and inefficiencies in City programs.

### BACKGROUND

The City Auditor's Office mission is to provide independent oversight of City operations and to be a catalyst for improving City government, building a more ethical and transparent culture, and building public trust in the City.

### POSSIBLE FUTURE ACTION

We will continue to address improving the ability of City staff to monitor the effective use of City resources through our training, consulting, follow-up work, and performance audits. We will continue to allocate staff resources that will result in the City receiving revenues it may not otherwise receive. We will continue to develop recommendations to identify and mitigate risks and to reduce costs in the long run.

### FISCAL IMPACTS OF POSSIBLE FUTURE ACTION

Future actions by the Auditor's Office should result in increased revenue and reduced expenditures, as well as reduced risk of loss, through the continued implementation of audit recommendations.

Actions taken by the City Manager and the City Council to address concerns over internal control risks should result in fewer unintended consequences in City operations.

### CONTACT PERSON

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### Attachments:

1: City Auditor's Annual Report for Fiscal Year 2008

# *City of Berkeley*



## City Auditor's Annual Report For Fiscal Year 2008

Prepared by:

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Claudette Biemeret, Auditor II

Presented to Council on December 8, 2008

# City Auditor's Annual Report for Fiscal Year 2008<sup>1</sup>

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<sup>1</sup> July 1, 2007 to June 30, 2008

## City Auditor's Message

"We're in this together"

[2008 Annual Report from the City Manager](#)

This year the City Auditor's staff developed over 60 ideas for improving City operations...and the City departments implemented our recommendations in an increasingly timely manner.

I'd like to thank my fellow department directors, the City Manager, the Council, and the community for asking good questions, for listening, and for supporting our efforts to help the City work better for all of us.

## What Changed Because of Our Audits?

"I liked the emphasis on measuring response times from the customer's perspective and on outcomes."

"One of the best audits I have read."

- Mayor & Council Audit Advisors

The most important measure of an auditor's work is this: What changed for the better because we were here? We know that the recommendations in this year's audits helped the City improve performance, reduce risks, and bring in new revenue.

(Note: All audits and reports below were Consent Calendar items on the City Council agenda for the meeting dates provided and *can be accessed by clicking on the report title*. They are available on the City [website](#) via the City Auditor's [home page](#) and the Council [agenda page](#).

## What Happens When You Call 911? Performance Improvements

[Response Times to Calls for Emergency Medical Services Could Be Improved](#) (June 24, 2008) - More patient-focused performance measures and other systems and service improvements would make Berkeley's better-than-average response times even better.

## When Bad Things Happen in Good Cities: Making Sure It Doesn't Happen Again

### Did You Know?

911 calls from cell phones may be delayed by routing to the Highway Patrol; Call 911 from landlines and **981-5911** from cell phones.

[Controls and Accountability for Police Asset Forfeiture Deposit Accounts Need Improvement](#) (September 11, 2007) - The Police Chief and the Police Review Commission requested we look into potential access to other assets in the Department, after a Berkeley Police Sergeant was arrested on suspicion of misusing controlled substances from the evidence room.

The Police Chief requested a review of Evidence Room Procedures by an outside consultant, and asked our office to follow up in one year, to make sure improvements were working as intended. The Police Chief also asked us to present our training, *Internal Controls and Fraud Prevention* to every Police Department employee, which we completed in the first quarter of the current fiscal year.

## Safeguarding Assets, Preventing Fraud, & Measuring Performance: Citywide Training

During fiscal year 2008 (FY '08) we presented our *Internal Controls for City Staff: Safeguarding Assets, Preventing Fraud, and Measuring Performance* training on internal controls and fraud prevention to 347 employees, for a total of 787 trained as of June 30, 2008. In the first quarter of the current fiscal year, an additional 194 employees were trained, including the 166 Police Department staff.

## Stopping Trouble Before It Starts – Averting Dangers and Managing Risk

Revenue at Risk? Medi-Cal Mental Health Interim Audit: Scope Limitation, Lack of Contract with County, Insufficient Monitoring of Remittances (April 22, 2008) - Berkeley's mental health services were budgeted at \$8.2 million dollars in 2007, but only \$1.2 million was from the General Fund. Without grants and assistance from County, State, and Federal sources, these services could disappear. We designed our audit to identify risks that could jeopardize this revenue and to offer solutions to mitigate them and presented this report to Council.

Audit of Controlled Substance in the Fire Department: Control Activities and Monitoring Should be Strengthened (October 9, 2007) - Improved inventory and monitoring systems will help ensure that controlled substances (drugs) needed for emergency medical services are not misused or misappropriated. Our recommendations were swiftly implemented.

Surprise cash counts address the risk of lost cash and damage to the City's ethical standards and public trust. Concerns about cash going missing and investigators' inability to identify suspects resulted in increased emphasis on controls over cash. City employees have the responsibility of handling money at over 90 locations in the City. According to our 2002 survey, amounts handled annually may range from less than \$1,000 to more than \$20 million, and not all departments had written procedures and adequate systems in place. Potential loss of funds and risk to employee safety, as well as public confidence, are inherent in cash handling. Similar findings in surprise cash count audits conducted at five locations this year indicate a citywide need to improve controls over cash handling:

- Animal Shelter Surprise Cash Count: Controls Need Improvement (October 9, 2007)
- Marina Surprise Cash Count: Controls Over Cash Receipts Need Improvement (October 9, 2007)
- Taxi Scrip Cash Count (January 15, 2008)
- Permit Service Center Surprise Cash Count: Need to Address Long Standing Security and Accountability Concerns (November 6, 2007)
- Nature Center Surprise Cash Count: Controls Over Cash Receipts Need Improvement (November 6, 2007)

"My opinion is that we have to make government as accountable and efficient as possible to win public trust and business as usual is not good enough. I am glad we have an auditor to assist in that effort."

- Berkeley Resident

## Pre-Audit of Payroll, Contracts, and Selected Payments

The City Charter gives the City Auditor a special role in reducing the risk of management override of internal controls, by granting oversight over payroll and other payments. Over 50,000 biweekly payroll checks are issued annually. The Charter also requires the Auditor to countersign and register all contracts. During FY '08, 538 contracts and contract amendments were reviewed and registered, a 22% increase over FY '07.

## Show Me the Money

In FY '08, **\$105,976** in business license taxes, penalties, and interest was collected as a result of audits.

### Business License Tax Program Audit Report for Fiscal Year 2007

(February 26, 2008) - Between 1982 and 2008, auditors billed taxes, penalties, and interest totaling nearly five million dollars. Since non-compliant businesses will often pay the correct tax after the audit, the identified revenue is not a one-time windfall, but generally becomes part of the future revenue stream. For each \$100,000 identified by audit, about \$16,666 in additional revenue can be expected for each future year, as long as the audited businesses continue to generate consistent sales. If all businesses audited since 1982 were still generating consistent sales, more than \$800,000 would be gained each year going forward. Our current program of auditing for underreporting also acts as a powerful deterrent to others considering shortchanging the City.

Audit revenues have declined because the City Manager's budget reductions eliminated two revenue audit positions between 2005 and 2007. However, planned improvements by the Finance Department in the software and systems for tracking Berkeley businesses could result in improved audit revenues and ongoing revenues in future years.

Ambulance Billing Audit resulted in an annual revenue increase of **\$235,000.**

2007 Ambulance Billing Audit (June 12, 2007) - Not all of the benefits of an audit are recognized right away. According to the City Manager's FY '08 Second Quarter Budget Update, during the first half of the fiscal year, the City collected 26.5% more ambulance revenue than for the same period in FY '07, or nearly \$300,000 in additional revenue. The City Manager made a conservative projection of an increase in these revenues for the year of over \$235,000 "primarily due to better billing and collection processes". He also increased future annual projected revenues for both billing improvements and fee increases.

## Can you hear me now? Policy and Internal Controls Alerts

Invisible Problems: Weak Internal Controls May Require Disclosure by City Manager and Council Action (October 9, 2007) 126 Opportunities to Increase Revenues, Control Costs, and Decrease Risk; What Happens to an Audit Recommendation Deferred? (March 25, 2008) - A significant benefit of performing audit work in house, rather than contracting it out, is that we are able to track and follow-up on the status of findings and recommendations on a continuing basis. The purpose of these two reports was to let Council know about the apparent root causes and the unacceptable level of risk of lack of prompt action on recommendations.

Failure to move forward on making improvements was linked to “invisible problems” exacerbated by budget cuts and pressure to minimize direct service reductions at the expense of reducing internal controls and oversight.

“Your procedures document for reporting back to Council is excellent and very helpful in formatting our responses effectively.”

- City of Berkeley  
Auditee (staff)

## Audit Follow up: Changes for the Better

Our audits don't just gather dust on a shelf; we follow up rigorously to make sure they have the intended impact. This year 100% of our audit recommendations were agreed to by the departments and the City Manager. This is better than our performance measure of 95% and better than the 82-93% rates reported by our peer auditors, according to the Association of Local Government Auditors (ALGA).

And the departments not only agreed – *they took action*. The rate of timely implementation of our recommendations (taking action before we publish the report) greatly improved. Even for longstanding and difficult action items, we finally saw a breakthrough. In January of 2008, there were 126 outstanding audit recommendations. As of October 2008, there are only 73 (according to the City Manager); 29 “in progress” from the 2008 audits, and 44 from audits going back as far as 1998 (see **Appendix A**).

Timely implementation rates hit a low of 26% in both FY '05 and FY '06. We worked hard to get attention and support from Council as well as staff, and by FY '08 the rate was back up to 52%.

Audit Recommendations Implemented Fiscal Years 2004 to 2008

Recommendations	2004	2005	2006	2007	2008
Percent accepted by auditee (goal: 95%)	100%	97%	100%	100%	100%
Average percent (by audit) reported implemented or partially implemented before report issued (goal: 40%)	37%	<b>26%</b>	<b>26%</b>	42%	<b>52%</b>
Percent reported implemented or partially implemented within one year (goal: 65%)	61%	79%	91%	48%	56%
Percent reported implemented or partially implemented within two years (goal: 95%)	81%	96%	91%	91%	90%

**Challenges and Risks Ahead: Berkeley is Not an Island**

We applaud the progress the City made this year in addressing some longstanding audit issues. At the same time, we are concerned that “invisible problems” could come back with a vengeance when the serious economic downturn forces the City to reduce staff, especially if cuts are “across the board” and impact oversight activities, once again.

The future impacts on the City of Berkeley from the State and Federal deficits we warned about in our [2007 Annual Report](#) are becoming more evident and more severe. The current economic downturn is in no small part both an effect and a cause of the federal government’s ever-increasing deficits. The California legislature’s September 2008 budget was based on unrealistic revenue projections. Worse yet, legislators could not agree on revenue increases or program reductions, and so agreed to take on more debt.

In last year’s report, we introduced these trickle-down deficit concepts as described by then U.S. Controller General David Walker.<sup>2</sup> More information is available at <http://www.iouathemovie.com/> and on the website of the Peter G. Peterson Foundation at <http://www.pgpf.org/>.

<sup>2</sup>As U.S. Controller General, Mr. Walker was the director of the Governmental Accountability Office (GAO). The GAO audits all federal programs on behalf of Congress and issues Generally Accepted Government Audit Standards. Audit firms performing the annual financial statement audits of local governments are required to follow those standards, as is Berkeley’s City Auditor. Mr. Walker, now retired, is devoted full time to educating the public about the future impact of unaddressed deficits.

**Did You Know?**

Council adopted a budget policy directing the City Manager to "Balance reductions to City administrative services so as not to jeopardize fiscal accountability."

March 23, 2004

Other cities are facing severe and sudden cuts in essential services, for a combination of reasons, including volatile economic trends, as well as unfunded mandates and take-back of revenue from higher levels of government. Berkeley's relatively stable economic base and conservative budgeting result in an excellent bond rating, but cannot insulate us from the effects of rapidly increasing economic pressures. The City's economic future is at risk not only from likely reductions in state and federal funding, but also because declining home values and economic activity will reduce General Fund revenue from property, property transfer, sales, and business taxes.

Some of the specific potential impacts on Berkeley are to its Public Health and Mental Health Services, which are largely paid for by non-City revenues. For example, the 2008 California budget planned future reductions to Berkeley's Mental Health funding of over a million dollars. Other future reductions in State and Federal grants could reduce services in all operating departments.

Public health and mental health services are a key component of Berkeley's overall public safety strategy and services. Police, Fire, Public Health and Mental Health account for a hefty majority of General Fund spending, and for nearly all of General Fund program and discretionary funding (as opposed to support services and mandated expenses). Other operating departments have General Fund allocations of between 1 to 3% of the total General Fund. Using a simplified program budgeting approach, a million dollars taken from Mental Health could only be replaced by taking a million dollars from Public Health, Police, or Fire.

**Budget Cuts May Have Weakened Internal Controls**

**Did You Know?**

Council voted to require that internal control risk analyses be included in annual departmental budget submissions, as recommended in the "Invisible Problems" report.

(October 9, 2007)

In the past, the City has tried to minimize cuts in direct services by also reducing the oversight and administrative services that support the programs. One of the great challenges of City leaders over the next few years is that, if Berkeley increases reductions in oversight services to avoid reducing programs, "invisible problems" will not be addressed and risks of unintended consequences will increase: Invisible Problems: Weak Internal Controls May Require Disclosure by City Manager and Council Action (October 9, 2007)

This appeared to be the case in December of 2005, when I issued Delayed implementation of Audit Recommendations and in 2003 Internal Control Risks Associated with Budget Cuts and Freezes. **Appendix A** lists outstanding audit recommendations that represent unaddressed risks, some identified many years ago, in the key areas of accountability, qualified and well trained staff, and adequate software.

As we grapple with increasing costs and shrinking revenues, it is more important than ever that the City vigilantly pursue fiscal, as well as environmental sustainability and inter-generational equity. Both require that we address our budgetary problems sooner rather than later.

Our audit strategy will continue to address improving 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.

**Performance  
Audit Division**

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  
McMillon  
- Administrative  
Assistant

## Who Are the Auditors?

Collectively, City of Berkeley auditors have over 80 years of combined professional audit experience. Our active engagement in local and national audit organizations has included board membership, publication in professional journals, presentations at audit conferences and the League of California Cities, and conducting peer reviews.

Berkeley's auditors have been in the forefront of the move to improve the quality and usefulness of audit work. We asked the voters to amend the Charter in 1998, to require that we follow Government Audit Standards, which require peer reviews of our audit work every three years.

In October 2006, the peer review found that the Berkeley City Auditor's Office was in full compliance with Generally Accepted Government Audit Standards for fiscal years 2004 through 2006, and awarded us the highest rating possible for quality and professionalism.

Audit work can lead to new revenue, cost recovery, and increased efficiency, which have an economic impact well beyond the audit costs.

## 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, and the public with objective, timely, and accurate information about City program performance. Our audits help make government more accountable. 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.

It is always better to acknowledge the reality about problems and work to solve them. An independent, professional auditor builds integrity throughout government, and public confidence grows when it sees a government that values transparency, frank self-assessment, and improvement through audits.

-Gary Blackmer, Portland City Auditor, Local Government Auditing Quarterly

**Appendix A**

**Open Audit Recommendations as of 10/31/08 (Issued through June 30, 2008)**

Title	Date of Audit Report	Total Recommendations	Total Outstanding	Time Elapsed Since Report Issued
Public Works Grants Audit	06-Jan-98	8	1	10 years; 9 months
Departmental Budget Monitoring Audit	23-Nov-99	15	4	9 years
Police Staffing Audit	30-Apr-02	11	3	6 years; 5 months
Cash Receipts/Cash Handling Audit - Treasury	17-Sep-02	19	1	6 years; 2 months
Customer Service Cash Receipts / Cash Handling Audit	08-Apr-03	23	3	5 years; 6 months
Information Systems General Controls Audit	16-Sep-03	27	3	5 years; 2 months
Accounts Payable Audit	16-Dec-03	16	1	5 years
FUND\$ Change Management Audit	04-May-04	23	11	4 years; 5 months
Citywide Contract Compliance Audit	18-May-04	18	3	4 years; 5 months
Purchase Order Audit - Select Public Works Divisions At the Corporation Yard	15-Mar-05	23	1	3 years; 7 months
Parcel Based Special Taxes, Fees, and Assessments Audit	15-Mar-05	22	6	3 years; 7 months
Audit of the Association of Sports Field Users	23-May-06	13	7	2 years; 5 months
Follow-Up Audit of Public Works Construction Contracts	27-Feb-07	22	13	1 year; 7 months
FY 2008 Surprise Cash Count: Permit Service Center	06-Nov-07	5	2	1 year
Audit of HHS Medi-Cal Mental Health Billings	25-Mar-08	2	2	6 months
Audit: Response Times To Calls for Emergency Medical Services Could Be Improved	24-Jun-08	12	12	4 months
<b>Total</b>		<b>259</b>	<b>73</b>	