



Office of the City Auditor

INFORMATION CALENDAR

June 26, 2012

To: Honorable Mayor and Members of the City Council
From: Ann-Marie Hogan, City Auditor
Subject: Audit Action: Reduce Fraud, Enhance Service Delivery and Revenue

INTRODUCTION

The City took action this year to reduce fraud risk and enhance service delivery and revenue by implementing recommendations from our performance audits, some issued as long ago as 2002.

CURRENT SITUATION AND ITS EFFECTS

Many recommendations outstanding at the time of our [2011 Report](#) are aimed at reducing the risk of fraud. Unfortunately, some of these recommendations are still being reported by the departments as not yet implemented. More troubling is our discovery, in a [recent audit](#), that other recommendations, previously reported implemented, are not implemented. We believe that these recommendations may have “become unimplemented” because of staffing changes made as a result of budget cuts in oversight and administrative functions. The result is an increase in the City’s risk of fraud.

BACKGROUND

The Auditor’s Office issues recommendations aimed at improving service delivery, enhancing revenue, and reducing the risk of fraud. The benefits of our audits come from the City’s implementation of our practical and expert advice. We issue periodic reports to Council about the changes made as a result of our audits, and those still pending. We have asked for Council action in reports such as [Invisible Problems: Weak Internal Controls Require Disclosure by City Manager and Possible Future Council Action on Budget and Workplans](#) and in our [2011 Annual Report](#).

Last year, audits reported fully implemented included all outstanding audits from Police (three), Mental Health (two), and the Fire Department. Human Resources completed work on their workers’ compensation audit, and Finance completed a duplicate payments and a contract fiscal management implementation. Public Works and Finance also implemented some recommendations on audits that are still open.

A recent audit highlighted concerns with internal controls. [Business License Taxes: Providing Better Guidance and Customer Service Will Increase Revenues](#) was presented to Council on May 29, 2012.

This audit was well received by Finance and the City Manager, and provided detailed recommendations on how to enhance customer service and productivity.

We did not find evidence of fraud in the business license function, but we found significant risks. Our audit identified three issues that our office and/or the City's external financial statement auditor have identified in previous audits, but that remain uncorrected:

- fraud risks associated with the lack of support and supervisory approval of adjustments,
- fraud risks related to the lack of reconciliation, and
- the need to hire a collection agency to pursue collection on delinquent accounts.

The financial statement auditors have previously identified fraud risks related to adjustments and reconciliation. Several of our audits, some of which had been previously reported closed, have also identified these risks:

- [Parks, Recreation & Waterfront Cash Receipts/Cash Handling Audit, September 2002](#)
- [Customer Service – Cash Receipts/Cash Handling Audit, April 2003](#)
- [Purchase Order Audit – Select Public Work Divisions at the Corporation Yard, March 2005](#)
- [Lack of Support for Payroll Adjusting Journal Entries: Grant Revenue at Risk?, October 2010](#)
- [Departmental Budget Monitoring Audit, May 1999](#)

Similar risks have allowed fraud to occur in other City functions and not be detected timely, as in the 1991 Review of Embezzlement of Monies in Police Department Administrative Office of Public Safety Business Office; and the 1993 Center Street Garage Embezzlement Audit.

The attached list of open recommendations notes those that represent fraud risk. In addition to risks from lack of reconciliation and problems with adjusting journal entries, three of these audits highlight a problem with the City's financial software, which does not sufficiently control computer access. This is known as a "segregation of duties" weakness, because it could allow an employee to both initiate and approve an improper transaction without detection.

POSSIBLE FUTURE ACTION

At the request of the City Manager, the City Auditor and Audit Manager recently met with the City Manager's executive staff and department directors to discuss how to assess risk and the importance of redesigning work properly when budget cuts are inevitable, to mitigate fraud risk as well as service impacts. Reaction to the training was very positive.

In our [December 13, 2011, Report to Council](#), we recommended that Council request the City Manager to:

- 1) Make timely implementation of audit recommendations a high priority and
- 2) Disclose the internal control risks of recommended budget cuts in future budget reports.

With the strong support of the City Manager, we believe the City can succeed in making timely implementation of our recommendations a high priority. Changing priorities, policies, and practices can reduce risks inherent in implementing budget cuts.

The role of the City Council in providing leadership in the face of budgetary and public pressure is critical. A policy of preserving front-line services at the expense of risk reduction is not sustainable.

FISCAL IMPACTS OF POSSIBLE FUTURE ACTION

Our annual reports dollarize the potential impact or resources at risk in the areas we audit. According to a 2010 study conducted by the Association of Certified Fraud Examiners (CFEs), a typical U.S. organization loses five percent of revenue to occupational fraud each year. Berkeley's FY2011 revenue was nearly \$370 million. Using the CFE estimate, about \$18.6 million would be lost if Berkeley were "typical." Increased emphasis on protecting City assets reduces the risk of loss.

CONTACT PERSON

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Attachments:

- 1: Open Recommendations as of June 30, 2012

Open Recommendations as of June 30, 2012

| Report Title | Open Recommendations | | |
|--|----------------------|-------------|------------|
| | Fraud Risk? | Fiscal Year | Total Open |
| Special Report to Council | | | |
| Invisible Problems: Weak Internal Controls Require Disclosure by City Manager and Possible Future Council Action on Budget and Workplans | ✓ | 2008 | 1 |
| Audit Reports | | | |
| Public Works Grants Audit | | 1998 | 1 |
| City-wide Payroll Audit | | 1999 | 2 |
| Customer Service Cash Receipts / Cash Handling Audit | ✓ | 2003 | 3 |
| Cash Receipts / Cash Handling Audit - Treasury | ✓ | 2003 | 1 |
| FUND\$ Change Management Audit | ✓ | 2004 | 3 |
| Purchase Order Audit - Select Public Works Divisions At the Corporation Yard | ✓ | 2005 | 1 |
| Audit of the Association of Sports Field Users | | 2006 | 7 |
| Follow-Up Audit of Public Works Construction Contracts | | 2007 | 4 |
| FY 2008 Surprise Cash Count: Permit Service Center | ✓ | 2008 | 1 |
| Leases Audit: Conflicting Directives Hinder Contract Oversight | | 2009 | 12 |
| Public Works Contract Monitoring: Risk of Overpayments / Lack of Inventory Controls | ✓ | 2010 | 2 |
| Improved Workflow Systems Will Help Ensure Property Taxes are Adjusted for New Construction | | 2010 | 2 |
| Utilization of Public Works Sewer Staff Can Be Improved | | 2010 | 2 |
| Audit: City Fuel Operations Need Improvement | ✓ | 2011 | 4 |
| Employee Benefits: Tough Decisions Ahead (Audit Report) | | 2011 | 5 |
| Lack of Support for Payroll Adjusting Journal Entries: Grant Revenue at Risk? | ✓ | 2011 | 1 |
| Equipment Replacement Fund - Sustainability and Transparency | | 2011 | 7 |
| Payment Card Acceptance Audit: Is Cardholder Information Safe? | ✓ | 2011 | 12 |
| Failing Streets: Time to Change Direction to Achieve Sustainability | | 2012 | 2 |
| Business License Taxes: Providing Better Guidance and Customer Service Will Increase Revenues | ✓ | 2012 | 19 |
| Total | | | 92 |

Note: 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.