

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

CONSENT CALENDAR
October 2, 2012

To: Honorable Mayor and Members of the City Council
From: Ann-Marie Hogan, City Auditor
Subject: City Auditor's Annual Report for Fiscal Year 2012

RECOMMENDATION

Request the City Manager:

1. Make timely implementation of audit recommendations a high priority, particularly the recommendations regarding fraud prevention, such as the 1998 grants audit and the 2011 adjusting journal entries audit. These recommendations aim to increase the Finance Department's oversight of practices in the departments.
2. Disclose internal control risks of recommended budget cuts in future budget reports.

SUMMARY

In 2012, we once again succeeded in our mission to improve performance of City operations, save money, promote transparency and accountability, and deter fraud. The City Manager and staff helped us achieve this by agreeing to take action on 100 percent of the 22 recommendations we made in our audit reports. Unfortunately, 2012 was another year of limited progress on some of the oldest outstanding recommendations aimed at reducing the risk of fraud and potential loss of federal and state grant funds. As of June 30, 2012, there were still 23 recommendations outstanding from ten reports we issued prior to fiscal year 2010.

FISCAL IMPACTS OF POSSIBLE FUTURE ACTION

We estimate that implementing the recommendations in the audits we issued in fiscal year 2012 could result in \$39 million in cost avoidance and revenue recovery over five-years.

CURRENT SITUATION AND ITS EFFECTS

Our audit, "[Failing Streets: Time to Change Direction to Achieve Sustainability](#),"¹ provided City management with the analysis needed to make data-driven decisions regarding street maintenance and repairs. Our report brought transparency to the high cost of deferred maintenance. Various funding scenarios demonstrated how street conditions would improve or decline and how the unfunded need would increase or decrease at the end of five years.

Our audit "[Business License Taxes: Providing Better Guidance and Customer Service Will Increase Revenues](#),"² provided guidance for preventing fraud risk and improving both efficiency and accountability for assessing and collecting business license taxes, penalties, and interest. The report identified the need to clarify business license provisions in the Berkeley Municipal Code and for Finance to develop comprehensive procedures to improve consistency in applying those provisions. The report also demonstrated the need for timely and aggressive collection efforts on delinquent accounts. Revenue should increase as a result. Fiscal year 2012 business license revenue was \$15.9 million.

The City received \$139,526 in taxes, penalties, and interest during fiscal year 2012 as a result of our business license tax audits. The business license audits we have conducted during the last ten years can be expected to generate an additional \$1.3 million over the next five years.

City management continued to support our efforts by implementing 71 of 125 open recommendations from prior-year audits. However, key recommendations affecting three of the City's most important risk areas continue to remain open:

- Lost opportunities for efficiencies or cost savings.
- The risk of losing state and federal grants and the lack of guidance and software to address that risk.
- The risk of fraud and the lack of computer controls to address that risk.

We once again urge the City Manager to implement the Council-adopted policy to include an analysis of internal control risks resulting from budget cuts in the annual proposed budget. The City Manager should balance reductions so as not to jeopardize fiscal accountability, and should state this as a budget policy.

BACKGROUND

The audit function is an essential element of the City of Berkeley's public accountability. The City Auditor's independence and accountability, mandated by the City Charter, means the public, the Council, and City staff can rely on us for objective information and practical advice. We rigorously review and analyze City performance, and we do our best to give you the information you need about complex and difficult issues.

¹ [http://www.ci.berkeley.ca.us/uploadedFiles/Auditor/Level_3_-_General/Streets%20Audit%20Report_Final\(2\).pdf](http://www.ci.berkeley.ca.us/uploadedFiles/Auditor/Level_3_-_General/Streets%20Audit%20Report_Final(2).pdf)

² [http://www.ci.berkeley.ca.us/uploadedFiles/Auditor/Level_3_-_General/BLT%20Revenue%20Collection%20Audit_Final\(1\).pdf](http://www.ci.berkeley.ca.us/uploadedFiles/Auditor/Level_3_-_General/BLT%20Revenue%20Collection%20Audit_Final(1).pdf)

RATIONALE FOR RECOMMENDATION

Taking action on our audits will reduce financial, regulatory, and operational risks. It will also help protect the City's good reputation.

CONTACT PERSON

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Attachment: City Auditor's Annual Report for Fiscal Year 2012

City of Berkeley



City Auditor's Annual Report Fiscal Year 2012

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Presented to Council October 2, 2012

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City Auditor’s Annual Report for Fiscal Year 2012

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City Auditor's Message

The Auditor's Office is an essential element of public accountability and transparency for the City of Berkeley. We conduct objective and rigorous reviews and analyses of City programs and make recommendations to promote the effective, efficient, economical, and ethical use of public resources. We perform our audits in accordance with generally accepted government auditing standards. These standards provide a framework for conducting high quality audits with competence, integrity, objectivity, and independence.

Our independent oversight and impartial analyses focus on ways to reduce various types of risk that can prevent the City from achieving its goals or operating in the most efficient and effective manner. Our office is a good investment of resources because we identify hard dollar recoveries, future dollar savings and cost avoidances, sources of additional revenue, and ways to deter fraud.

"I'm proud to be a citizen of the city in which you practice your auditor skills!"

- Berkeley resident

In 2012, we succeeded in our mission to improve performance of City operations, save money, promote transparency and accountability, and deter

fraud. The City Manager and department staff helped us achieve this by agreeing to implement all 22 of the recommendations we made in our 2012 audit reports. They also implemented 71 of the 125 recommendations that were outstanding from older audit reports as of September 30, 2011. We closed 11 audits as a result.

Unfortunately, 2012 was another year of limited progress on some of the oldest outstanding recommendations aimed at reducing the risk of fraud and potential loss of federal and state grant funds. As of June 30, 2012, there were still 23 recommendations outstanding from ten reports we issued prior to fiscal year 2010.

OUR MISSION

To be a catalyst for improving city government. Our audits, mandated by the City Charter, provide the City Manager, City Council, and the public with objective, timely, and accurate information about how well City programs and activities are performing. By providing this information and making recommendations for improvement, we help to hold government accountable in its stewardship of the public trust.

FY 2012 REPORTS

- Failing Streets: Time to Change Direction to Achieve Sustainability
- Investing in Sustainability: Streets Audit Follow-up and Stormwater
- Business License Taxes: Providing Better Guidance and Customer Service Will Increase Revenues
- Business License Tax Program Audit Report for Fiscal Year 2011
- Audit Action: Reduce Fraud, Enhance Service Delivery and Revenue
- City Auditor's Annual Report for Fiscal Year 2011

NOTE: All reports discussed in this report can be found on the City Auditor's website at:

http://www.ci.berkeley.ca.us/Auditor/Home/Audit_Reports.aspx

Auditor's Office Wins National Award!



The Auditor's Office won the 2011 Knighton Bronze Award from the Association of Local Government Auditors (ALGA) for our performance audit, "[Failing Streets: Time to Change Direction to Achieve Sustainability.](#)"

With more than 1,750 members, ALGA is the professional organization of choice for local government audit professionals throughout the United States and Canada. The Knighton Awards recognize the best performance audit reports issued by ALGA members each year. The purpose of the award is to improve government services by encouraging and increasing levels of excellence among local government auditors.

ALGA judges evaluated the report on several key elements, including the potential for significant impact; the persuasiveness of the conclusions; the focus on improving government efficiency and effectiveness; and its clarity, conciseness, and innovation.

The judges said:

"...the report used excellent graphics, tables and charts to present a clear roadmap of the issue and the solutions."

Failing Streets: Time to Change Direction to Achieve Sustainability

Reconstructing a failed street in Berkeley costs about 32 times as much as timely maintenance! The City can avoid \$1.1 million in repair costs for every mile that it properly maintains.

Berkeley's streets are in a serious state of disrepair with the average street at risk of failing. More than 134 (62 percent) of the 216 linear miles of streets must be resurfaced or reconstructed because they have deteriorated to the point where less costly preventive maintenance work, such as crack and slurry sealing, is no longer an effective option. The streets budget is only \$3.66 million a year, which limits Public Works' ability to do more, and results in a growing unfunded need for street rehabilitation. At the current funding level, future costs for work deferred will increase

more than \$30 million in five years, to \$70.8 million. Spending \$17.5 million in each of the next five years would eliminate the unfunded need. Although it would take longer, spending \$10 million annually is the minimum amount needed to change direction and start reducing the unfunded need. We recommended that the Department of Public Works begin using StreetSaver® to develop data-driven funding strategies.

The Average Berkeley Street Is at Risk of Failure



Investing in Sustainability: Streets Audit Follow-up and Stormwater

If City infrastructure is not repaired and rehabilitated at a sustainable level, unfunded needs will continue to escalate and future generations may be denied essential services because of the high cost of delayed repairs.

The City is projecting to budget \$3.6 million in fiscal year 2014 for street rehabilitation. Our audit, "[Failing Streets: Time to Change Direction to Achieve Sustainability](#)," showed that 12 percent of Berkeley's streets are currently "failed" and unfunded needs are more than \$40 million. At this low funding level, failed streets would increase to 21 percent and unfunded needs would increase to nearly \$71 million at the end of five years. This is because maintaining streets costs \$36,000 to \$309,000 per mile, but reconstructing a failed

street costs \$1.15 million per mile. A \$10 million budget would begin to reverse the direction by the end of five years - street conditions would improve from the low to high end of "fair" and the unfunded need would decline to \$32 million. The Council used the data analysis in our audit in making their decision to place a \$30 million bond measure on the November 2012 ballot for street and related stormwater management improvements.

"Enjoyed your last report. Wish there were more of you in the city government!"

- Berkeley resident

Berkeley's Average Cost of Rehabilitation by Condition Category			
Condition Category	Rating Category and PCI Range	Treatment	Average Cost Per Mile
I	EXCELLENT (100-90)	Crack Seal and Slurry Seal – Comprehensive maintenance used to repair distress and reinforce weakened pavement	\$36,065
I	GOOD (89-70)		
II/III	FAIR (69-50)	Thin Asphalt Concrete Overlay – Grind surface layer, repair base, and replace surface with a thin (1½") overlay	\$125,657
IV	POOR (49-25)	Thick Asphalt Concrete Overlay – Grind surface layer, repair base, and replace surface with a thick (2½") overlay	\$309,464
V	VERY POOR/FAILED (24-0)	Reconstruction – Excavate entire roadway and replace pavement structure (surface layer and base)	\$1,153,181

Business License Taxes: Providing Better Guidance and Customer Service Will Increase Revenues

"I think your Office did a very good job that will be helpful in improving the efficiency and effectiveness of the Finance Department. Thank you."

- City of Berkeley
Finance Director,
in response to this audit

The City's business license tax code is complex and unclear, guidance is insufficient, and responsibilities are not clearly assigned. As a result, Finance staff did not always assess taxes, penalties, and interest accurately and consistently. Errors and inconsistencies may result in taxpayers being treated inequitably and can lead to businesses appealing their cases.

The audit also identified three fraud risks related to business license activities: 1) staff performing incompatible duties; 2) lack of reconciliation, and 3) insufficient support for and lack of supervisory review of adjustments. Prior audits by both our office and the City's external financial statement auditor identified all three of these issues as citywide concerns.

Collection on delinquent accounts also needs improvement. More than \$700,000 owed on delinquent business license accounts was beyond the statute of limitations for collection. Because the collectability of delinquent accounts declines rapidly, Finance was likely to collect only about \$50,000 of the remaining \$380,000 in delinquent business license accounts. Following recognized best practices for more timely and persistent collection efforts on delinquent business license accounts could generate additional revenue of \$90,000 annually.

Improving collection activities on delinquent business license accounts could generate additional revenue of \$90,000 annually.

Our report made 20 recommendations that focus on ways to improve consistency in applying the City's business license tax ordinance; the accuracy in assessing business license taxes, penalties, and interest; and collection of delinquent business license accounts. As a result of implementing our recommendations, Finance should see increased efficiencies, reduced risk of fraud, and more revenue.

Business License Tax Audits: An Ongoing Source of Revenue

Since 2003, the City has received \$1.2 million as a result of our business license tax audits.

Our business license tax audits increase the public's awareness about Berkeley's business license requirements and help bring unlicensed and underpaying businesses into compliance. The City received \$139,526 in unpaid taxes, penalties, and interest during fiscal year 2012 as a result of our current- and prior-year business license tax audits. The penalties and interest are one-time revenues, but the taxes are an ongoing revenue stream for the City for as long as these businesses continue to operate in the City of Berkeley. As a result, the business license audits we have conducted over the last ten years can be expected to generate an additional \$1.3 million over the next five years.

Audit Action: Reduce Fraud, Enhance Service Delivery and Revenue

Preserving front-line services at the expense of reducing risk is not sustainable.

Many recommendations outstanding at the time of our 2011 Annual Report are aimed at reducing the risk of fraud. Unfortunately, departments have not implemented all of these recommendations, some dating as far back as 1998 (see Appendix A for a list of open audit recommendations). More troubling is our discovery in our recent audit, "[Business License Taxes: Providing Better Guidance and Customer Service Will Increase Revenues](#)," that other recommendations, previously reported as implemented, are not implemented. The benefits of our audits come from the City's implementation of our practical and expert advice. This Council report highlighted three types of fraud risks that remain uncorrected. Similar risks have allowed fraud to occur in the City. We emphasized the importance of making timely implementation of our recommendations a high priority and for Council to recognize that preserving front-line services at the expense of reducing risk is not sustainable.

Significant Progress Made on Implementing Recommendations From Prior-Year Audits, but More Action Needed

City departments' implementation of 71 open recommendations resulted in improved efficiency and oversight of City operations and eliminated the potential for fraud and loss of grant funds.

Our audit recommendations improve performance of City operations, save money, and promote transparency and accountability. We collaborate with department staff as we conduct our audits to ensure our recommendations are practical and feasible to implement. Doing this ensures a higher implementation rate and helps achieve the ultimate goal of improved City operations.

City staff implemented 71 (57 percent) of the 125 recommendations from prior-year audits that were open as of September 30, 2011. This allowed us to close 11 prior-year audits. The recommendations in these audits focused on improving efficiency and oversight of City operations, as well as eliminating the risk of fraud or the potential loss of grant funds.

The table below lists the audits that we closed, followed by those that are still open but had recommendations implemented during the year.

Closed Audits	Recommendations Implemented
Accounts Payable Audit	1
Association of Sports Field Users	7
Efficiency and Transparency of Contract Fiscal Management Needs Improvement	4
HHS Medi-Cal Mental Health Billings	1
Improved Workflow Systems Will Help Ensure Property Taxes are Adjusted for New Construction	1
Mental Health Adult Clinic Surprise Cash Count: Client Funds Could Be Lost, Stolen, or Misused	3
Over \$38,000 in Duplicate and Over Payments Recovered	7
Parcel Based Special Taxes, Fees, and Assessments Audit	1
Police Property and Evidence Room: Further Improvements	5
Police Staffing Audit	3
Workers' Compensation Policies and Procedures	7
SUBTOTAL	40

Progress on Open Audits	Recommendations Implemented
City Fuel Operations Need Improvement	10
Employee Benefits: Tough Decisions Ahead (Audit Report)	1
Equipment Replacement Fund - Sustainability and Transparency	7
FUND\$ Change Management Audit	2
Lack of Support for Payroll Adjusting Journal Entries: Grant Revenue at Risk?	2
Leases Audit: Conflicting Directives Hinder Contract Oversight	4
Public Works Contract Monitoring: Risk of Overpayments / Lack of Inventory Controls	2
Utilization of Public Works Sewer Staff Can Be Improved	3
SUBTOTAL	31

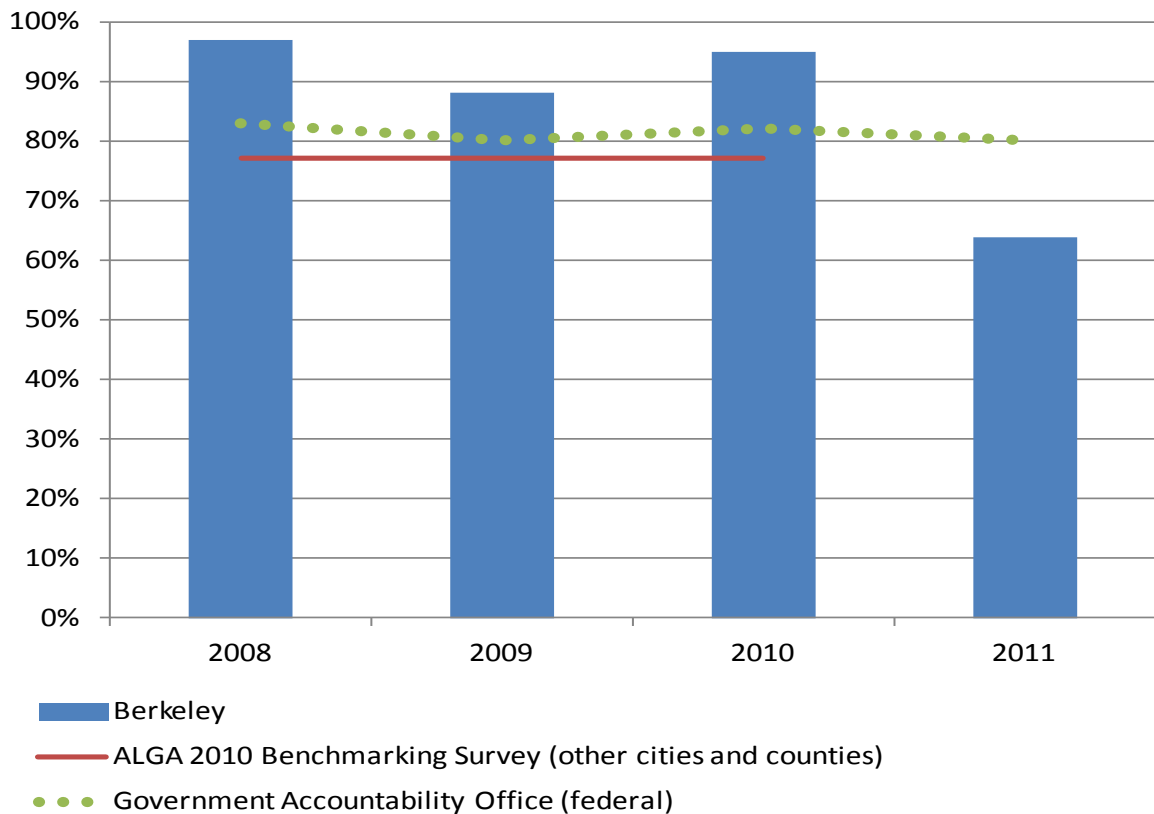
TOTAL RECOMMENDATIONS IMPLEMENTED	71
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Status of Audit Recommendations by Fiscal Year: 2008 Through 2012

	2008	2009	2010	2011	2012*
Number of Recommendations	63	67	92	80	22
Percent of Recommendations Accepted	98%	99%	100%	100%	100%
Fully Implemented (closed)	61	59	87	51	0
Percent Implemented	97%	88%	95%	64%	0%
Partially Implemented (open)	0	7	3	12	1
Not Implemented (open)	1	0	0	17	21
Percent Open	1.5%	10%	3%	36%	100%
Will Not / Cannot Implement (closed)	1	1	2	0	0
Percent Will Not or Cannot Implement	1.5%	1%	2%	0%	0%

* The status reports for the audits we issued in FY 2012 are not yet due. Therefore, we do not have updated information on how many of the 21 open recommendations have been implemented since the report was issued.

Recommendation Implementation Rates Compared to Other Audit Organizations



Stopping Trouble Before It Starts: Fraud Prevention Training

“Thank you for an excellent training and for being such a wonderful resource for us to inculcate awareness!”

- Presentation attendee

Our office has an important role in preventing fraud, waste, and abuse that extends beyond conducting audits. At the request of the City Manager, the City Auditor and Audit Manager provided a fraud presentation to all department directors. We explained what fraud is and provided several examples of fraud that has occurred in government entities, as well as statistics on the demographics of people who commit fraud. We “brought it home” by providing examples of past frauds that have occurred in the City and the weaknesses that allowed them to occur. With a focus on eliminating opportunity, we provided details about what City management can do to prevent fraud from occurring in the future or to identify it timely if it does. The City Auditor subsequently did a similar presentation, at the request of the Director of Health, Housing, and Community Services, to staff in community agencies that receive grant funds from the City. The City Auditor and audit staff also gave a fraud presentation to staff in the Department of Information Technology.

Audit Cost Savings – Fiscal Year 2012

Our audit recommendations improve performance of City operations, save money, promote transparency and accountability, and mitigate risk. Often, our audit recommendations also result in efficiencies that improve service delivery, program quality, cost savings, or revenue increases that we cannot easily quantify. As a result, actual cost recoveries or dollar savings may be much more than the amounts we cite in our audits. For example, the increased revenue due to efficiency and effectiveness improvements we identified in our audit, ["Business License Taxes: Providing Better Guidance and Customer Service Will Increase Revenues,"](#) may far exceed the \$90,000 annual amount that we dollarized in the audit report. The table below lists the estimated savings we quantified our fiscal year 2012 audits.

2012 Audits With Cost Avoidance, Potential Savings, or Revenue Recovery	Type of Savings	Potential Five-Year Savings
Failing Streets: Time to Change Direction to Achieve Sustainability*	Cost Avoidance	\$38,536,106
Business License Taxes: Providing Better Guidance and Customer Service Will Increase Revenues	Revenue Recovery	450,000
Business License Tax Program Audit Report for Fiscal Year 2011	Revenue Recovery	140,306
TOTAL		\$39,126,412

*The potential savings for the streets audit is based on performing work more timely, and less expensively, if voters approve the Alameda County transportation tax and City bond measure for streets and related infrastructure in November 2012. Approval of both would increase funding from \$3.6 million to \$10.4 million annually, allowing the unfunded need to decline from \$70.8 million to \$32.2 million at the end of five years.

Transparency and Risk Reduction

Berkeley's Charter gives the City Auditor a role in reducing the risk of management overriding procedures established to prevent fraud. We do this through oversight of payroll and other payments:

Contracts

The City Charter requires the Auditor to countersign and register all contracts. We reviewed and registered 528 contracts and contract amendments, valued at \$193 million, in fiscal year 2012. The City Clerk posts the contracts to Records Online at <http://www.ci.berkeley.ca.us/recordsonline/search.aspx>.

Payroll Audit

Payroll Audit continues to improve the accuracy, integrity, and efficiency of the City's payroll system. Key accomplishments in fiscal year 2012 include:

- Provided many detailed, specific suggestions to the Department of Human Resources to use in union negotiations, with a goal of increasing conformity among the City's seven Memoranda of Understanding (MOUs). Having conformity among the MOUs saves costs because it reduces payroll complexity.
- Advised and assisted the Berkeley Housing Authority in its transition to a commercial payroll service for payroll and benefits processing.
- Increased the security and integrity of the City payroll system by further limiting who can access and change certain payroll screens that control salaries and benefits.
- Increased the number of payroll forms and documents that are available electronically. City employees, supervisors, and payroll clerks can now access and print these as needed.

We increased the number of payroll forms and documents available electronically.

About Us

Staff in the City Auditor's Office have extensive knowledge of auditing methods and techniques. We maintain and improve our knowledge and skills by participating in continuing professional courses annually, as required by the government auditing standards. Collectively, the performance auditors have more than 100 years of professional audit experience and the payroll auditors have more than 150 years of payroll experience. Many of our staff hold professional certifications, including:

- Certified Internal Auditor (CIA)
- Certified Government Audit Professional (CGAP)
- Certified Payroll Professional (CPP)
- Certified Public Accountant (CPA)
- Certified Fraud Examiner (CFE)

Auditors from other local government audit organizations review our performance audit work every three years to ensure we continue to meet the requirements of the government auditing standards, which is the professional framework that the City Charter requires us to follow.

Performance Auditors:

- Ann-Marie Hogan, CIA, CGAP
 - City Auditor
- Harriet Richardson, CPA, CIA, CGAP
 - Audit Manager
- Frank Marietti, CFE, CIA, CGAP
 - Senior Auditor
- Claudette Biemeret, CGAP
 - Senior Auditor
- Jack Gilley, CFE
 - Auditor II (retired)
- Myrna Ortiz
 - Auditor I
- Sherren Styles
 - Administrative Assistant

Payroll Auditors:

- Dr. Brian Zandipour, CPP
 - Deputy City Auditor, Payroll
- Leo Reyes
- Ann del Rosario
 - Auditor II
- Agnes Celis
- Candice Schott
 - Accounting Technicians
- Raul Chan
- Gail Wread
 - Accounting Office Specialist III

Conclusion

The Auditor's Office is a good investment because the City saves money and increases performance when the City Manager and department directors act on our recommendations. Management took significant actions to clear open recommendations this year, but there is more work to be done. The value of our work is in the long-term changes that occur when management implements our recommendations. We will continue to provide a roadmap for continuous improvement of City services.

Appendix A: Open¹ Recommendations as of June 30, 2012

Report Title	Risk Category	Open Recommendations	
		Fiscal Year	Total Open
Risk Categories: E = Efficiency; F = Fraud; G = Grants; O = Oversight			
Special Report to Council			
Invisible Problems: Weak Internal Controls Require Disclosure by City Manager and Possible Future Council Action on Budget and Workplans	E, F, G, O	2008	1
Audit Reports			
Public Works Grants Audit	E, F, G, O	1998	1
City-wide Payroll Audit	E, O	1999	2
Customer Service Cash Receipts / Cash Handling Audit	F, O	2003	3
Cash Receipts / Cash Handling Audit - Treasury	E, F, O	2003	1
FUND\$ Change Management Audit	F, O	2004	3
Purchase Order Audit - Select Public Works Divisions at the Corporation Yard	E, F	2005	1
Follow-Up Audit of Public Works Construction Contracts	E, F, O	2007	3
FY 2008 Surprise Cash Count: Permit Service Center	F	2008	1
Leases Audit: Conflicting Directives Hinder Contract Oversight	E, O	2009	7
Public Works Contract Monitoring: Risk of Overpayments / Lack of Inventory Controls	E, F	2010	1
Utilization of Public Works Sewer Staff Can Be Improved	E, O	2010	2
Audit: City Fuel Operations Need Improvement	F, O	2011	4
Property and Evidence Room POST Study: Follow-up Audit	E, F	2011	1
Employee Benefits: Tough Decisions Ahead (Audit Report)	E, O	2011	4
Lack of Support for Payroll Adjusting Journal Entries: Grant Revenue at Risk?	F, G, O	2011	1
Equipment Replacement Fund - Sustainability and Transparency	E	2011	7
Payment Card Acceptance Audit: Is Cardholder Information Safe?	F, O	2011	12
Failing Streets: Time to Change Direction to Achieve Sustainability	E, O	2012	2
Business License Taxes: Providing Better Guidance and Customer Service Will Increase Revenues	E, F, O	2012	20
TOTAL			77

¹ Open recommendations include those that are in progress and those that the auditee has not yet started to implement. It excludes recommendations that the auditee will not or cannot implement.