



Office of the City Auditor

INFORMATION CALENDAR

December 13, 2005

To: Honorable Mayor and
Members of the City Council

From: Ann-Marie Hogan, City Auditor

Subject: City Auditor's Annual Report for Fiscal Year 2005

SUMMARY

Attached is the City Auditor's Annual Report for Fiscal Year 2005. This report will be available on the City Auditor's website.

CURRENT SITUATION AND ITS EFFECTS

In fiscal year 2005, the City Auditor's Office issued the following audit reports:

- Business License Tax Program Audit Report for Fiscal Year 2004,
- Parking Enforcement Operations Audit,
- Parcel Based Special Taxes, Fees, and Assessments, and
- Purchase Order Audit – Select Public Works Divisions at the Corporation Yard.

We also issued the Report on the Impact of the Medi-Cal Provider Rate Reduction on Medi-Cal Reimbursements, a non-audit service report performed in response to a request made by the City Manager.

The City Auditor's Office assessed \$158,098 in Business License tax revenue. The total amount collected was \$59,647. The average dollars assessed per audit was \$9,372. Assigned in this area was 1.5 FTE (full time equivalent employee).

The City Auditor's Office also reviewed 451 contracts and presented 7 fraud trainings to City staff from various City departments.

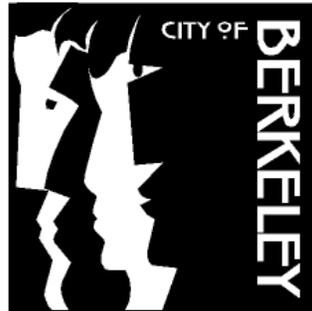
POSSIBLE FUTURE ACTION

Over the past three years, the implementation rate of our audit recommendations significantly decreased. The City Auditor is responsible, by Government Audit Standards, for following up on the implementation of the audit recommendations. The City has been under increasing budgetary pressure to cut corners in terms of internal controls, in order to protect front line services. In order to address that risk, the auditors plan to spend increasing amounts of our resources to monitor the implementation of our recommendations for improvements.

CONTACT PERSON

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City of Berkeley



City Auditor's Annual Report For Fiscal Year 2005

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Presented to Council on December 13, 2005

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City Auditor's Annual Report for Fiscal Year 2005
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I. Background

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.

The City Auditor is elected; this establishes the organizational independence from management required by Generally Accepted Government Auditing Standards (GAGAS). The City Auditor reports the results of audits and other investigations and reviews to Council, the City Manager, and Berkeley residents. The City Auditor works with the City Manager, City staff, and an audit committee of Council to develop the annual audit plan. Current members of the audit committee are Mayor Bates and Council Members Capitelli, Maio, and Wozniak.

Independent Auditors are a Good Investment

Independent internal auditors enhance accountability to taxpayers and bondholders and build credibility with residents. The presence of auditors can deter employees from committing fraud because of the perceived danger of getting caught. In addition, we prevent problems and improve efficiency by evaluating controls through regular reviews of organizational activities.

A significant benefit of performing the audit work in house is that we are able to track and follow-up on the status of findings and recommendations on a continuing basis. The ultimate benefit from audit work is in the effective resolution of findings reported and recommendations made.

Audit work can lead to new revenue, cost recovery, and economic impact well beyond the audit department's annual budget. If structured and staffed appropriately, an independent performance audit department can be extremely effective and productive. It is an investment that benefits the City.

Who are the Auditors?

The City's trusted, professional audit staff for fiscal year (FY) 2005 include auditors who have been awarded recognition as Certified Internal Auditors (CIA), Certified Government Auditing Professionals (CGAP), a Certified Public Accountant (CPA), and Certified Fraud Examiners (CFE). Staff have also been awarded advance degrees in Public Policy and Management (MSPPM) and Public Affairs (MPA):

According to the Association of Certified Fraud Examiners, a typical organization can lose 6% of revenue to occupational fraud.

• City Auditor	• Ann-Marie Hogan	• CIA, CGAP
• Audit Manager	• Teresa Berkeley-Simmons	• CIA, CGAP
• Senior Auditor	• Frank Marietti	• CIA, CGAP, CFE
• Auditor II	• Jocelyn Nip	• CPA,CFE
• Auditor II	• Abiud Amaro	• MSPPM
• Auditor I	• Emily Leitz	• MPA

Audit staff are members of or participate in professional organizations such as:

- American Institute of Certified Public Accountants (AICPA)
- Bay Area Local Government Auditors (BALGA)
- Institute of Internal Auditors (IIA)
- National Association of Certified Fraud Examiners (CFE)
- National Association of Local Government Auditors (NALGA)

Participation in these organizations allows us to obtain inexpensive access to high quality training opportunities, as well as audit programs and benchmarking information from other jurisdictions.

Our work is ably supported by Administrative Secretary Sherren McMillon, who also supports the Payroll Audit Division and monitors the Department's budget.

Who Audits the Auditor?

The City Charter requires the City Auditor to conduct audits in conformance with GAGAS. This includes undergoing a Peer Review by the National Association of Local Government Auditors (NALGA) every three years. Our most recent peer review was performed in October 2003. Our next Peer Review is due October 2006.

The results of the two most recent Peer Reviews (issued 2000 and 2003) awarded our Office the highest rating possible for quality and professionalism. Moreover, the Peer Reviewers noted several areas in which our office excelled. These areas include:

- Developing high quality audit programs,
- Successfully communicating with management during key phases of the audit,
- Issuing timely audit reports,
- Management's high degree of acceptance of our audit recommendations, and
- Hiring and developing well-qualified and credentialed audit professionals.

The City Auditor's Office was given the best rating possible by its Peer Reviewers for the most recent reviews performed in the past eight years.

Key Performance Measures

	Measure	Actual
Audits completed in accordance with Government Auditing Standards	100%	100%
Number of high quality completed projects per fiscal year as a percent of plan*	-----	50%
Percent of recommendations accepted by auditee	95%	97%
Percent of recommendations reported implemented or partially implemented by operating departments before report issued	40%	26%
Percent of recommendations reported implemented or partially implemented by operating departments within one year	65%	79%
Percent of recommendations reported implemented or partially implemented by operating departments within two years	85%	96%

* Due to position vacancies and family leave taken by staff, during FY2005 the Auditor's Office returned to the City's General Fund salary savings of nearly 2 FTEs. This had a negative impact on completion of the audit plan as well as generation of Business License Revenues. However, we were able to contribute to the reduction of the City's budget shortfall.

II. Audit Report Summaries

Here we summarize some audits that contributed to positive changes or positive results for the City. We have included information from our performance measurement system about the number of recommendations made and how many of them were reported implemented, partially implemented, or not yet implemented by the audited department at the time of the most recent report to Council. It should be noted that, while some recommendations can be implemented swiftly, others may require substantial efforts on the part of multiple departments, extensive changes to the City's accounting software, redirection of resources away from front line functions, or even a vote of the public. It should also be noted that some of these audits are more recent than others, giving less time to complete implementation. For this reason, the reader should take care to avoid making assumptions about the comparative responsiveness of one department versus another.

Business License Tax Program Audit Report for Fiscal Year 2004
(Issued November 9, 2004)

The report identified the Business License tax revenue identification efforts and accomplishments of the Auditor's Office during FY2004. Business License Tax Program audits resulted in 17 businesses being billed a total of \$125,070 during FY2004. During the fiscal year, \$133,038 was collected, of which \$82,981 was from prior year billings.

Between 1982 and 2004, auditors identified revenues totaling \$4,537,588. 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 \$18,000 in additional revenue can be expected for each future year, as long as the audited businesses continue to generate consistent sales.

Parking Enforcement Operations Audit (Issued February 22, 2005)

This audit was performed to evaluate the operational and policy issues tied to the City's Parking Enforcement operations. The scope of this audit was expanded to include a walkthrough of cash handling of meter coin revenue.

The audit found that the number of citations issued per Parking Enforcement Officer (PEO) decreased for a variety of reasons including obstacles beyond the PEOs' control. We also found that monthly reports on PEO activity and results were not verified or reconciled to the available data and appeared insufficient for decision-making purposes. Finally, internal controls over cash handling of coins from meters by the Office of Transportation could be strengthened.

What did the auditees say about the audit? "The audit tried to be responsive to the City Manager."

Number of Recommendations Issued	20
Number of Recommendations Accepted by Auditee	20
Number of Recommendations Implemented or Partially Implemented Per Auditee as of 6/30/2005*	12

* City Manager's status report addressing the outstanding recommendations is scheduled to go to Council February 2006.

Parcel Based Special Taxes, Fees, and Assessments (Issued March 15, 2005)

The audit was performed to evaluate the internal controls and identify risk for the parcel based assessment processes, and to determine whether the:

- Parcel/property data used for assessment is materially accurate and complete.
- Assessments are computed correctly.

What did the auditees say about the audit? "The auditor was respectful of our time constraints and used our time well."

The audit identified 23 properties that were potentially under-assessed or not assessed. The estimated amount of unbilled taxes that can be back billed for tax year 2003-2004 is approximately \$32,000. We also found a potential annual gain by the City may be as high as \$1.2 million if non-public exempt entities are assessed for City Landscape/Parks, City Library Services, Paramedic Supplement, Physically Disabled, and CFDI Disaster Fire Tax. The potential annual gain by the Berkeley Unified School District may be as high as \$0.8 million if non-public exempt entities are assessed for Berkeley School Tax and School Maintenance Tax. Also, if the capital improvement portion of the Clean Storm Water Fee is assessed on properties held by non-City public agencies such as the Regents of the University of California, the East Bay Regional Park District, and the Berkeley Unified School District, it could generate \$215,000 of additional revenue to the City annually.

Number of Recommendations Issued	22
Number of Recommendations Accepted by Auditee	21
Number of Recommendations Implemented or Partially Implemented Per Auditee as of 6/30/05*	7

* City Manager's status report addressing the outstanding recommendations is scheduled to go to Council January 2006.

Purchase Order Audit – Select Public Works Divisions at the Corporation Yard (Issued March 15, 2005)

The audit was performed to:

- Determine if purchase order purchase and payment activity for the Equipment Maintenance Division and Streets and Utilities Division of the Public Works Department:
 - Is in compliance with written policies and procedures.
 - Has an adequate internal control structure.
- Evaluate the effectiveness of efforts by Equipment Maintenance Division and Streets and Utilities Division staff to reduce workers' compensation claims.

What did the auditees say about the audit? "I think it identified some problem areas that needed to be addressed."

The audit found that the City's Purchasing Manual is very outdated. We found a lack of segregation of duties in that staff in the Equipment Maintenance Division and Street and Utilities Division can perform one or more incompatible purchasing related duties. Parts inventory in Equipment Maintenance is not secure, and procedures are not in place to detect parts inventory used for purposes other than to repair City equipment. There is a lack of sufficient competitive pricing. We also found that the monthly

documented safety inspections required by the City's Illness and Injury Prevention Plan are seldom performed in the Streets and Utilities Division.

Number of Recommendations Issued	23
Number of Recommendations Accepted by Auditee	22
Number of Recommendations Implemented or Partially Implemented Per Auditee as of 6/30/05	6

*City Manager's status report addressing the outstanding recommendations is scheduled to go to Council December 6, 2005.

III. Other Program Services

Report on the Impact of the Medi-Cal Provider Rate Reduction on Medi-Cal Reimbursements (Information Item issued October 5, 2004)

In the fiscal year 2005 State budget proposal introduced in November 2003, the Governor called for a 10% reduction in Medi-Cal provider rates, in addition to the 5% approved reduction made in the State Budget Act of 2003. The City Manager requested the City Auditor's Office to evaluate its financial impact since the rate reduction might significantly reduce Medi-Cal reimbursements and worsen the City's budget deficits.

We agreed to perform this non-audit service. We examined the impact based on budget information made available to the public. Our purpose was to identify the trend and impact of unreimbursed Medi-Cal expenses in consideration of the enacted and proposed rate reduction.

Compliance Audit: Business License Tax (BLT)

Historically the auditors focused on businesses that were unlicensed or underreporting and were identifying revenue at a first year cost to total staff expense ratio of 4:1. Since FY2003, the auditors' focus was limited to underreporting. In FY2003, the auditors identified revenue at a (first year) revenue to employee cost ratio of 2.5:1. In FY2004, we identified revenue at a (first year) revenue to employee cost ratio of 1.4:1. This indicates that the cost/benefit may be greater for unlicensed than underreporting.

With a reduction in staff and an increase in costs during FY 2005, the Auditor's Office has been considering available options to identify additional BLT revenue. Some options under consideration: developing new data analysis, and solutions to

The City Auditor's Office assessed \$158,098 in Business License tax revenue and reviewed 451 City contracts.

focusing on different revenue streams. However, continuous monitoring for underreporting is an important deterrent. In FY2005, our performance measure was \$125,000 per assigned employee. With 1.5 FTE (full time equivalent employee) assigned in this area, total amount assessed was \$158,098. Total amount collected was \$59,647. The average dollars assessed per audit was \$9,372. The auditors will include both unlicensed businesses and potentially underreporting businesses in future audit plans, and will continue to monitor cost, benefit, and future revenue projections.

Contracts

The City Charter requires that all contracts be countersigned and registered by the City Auditor. Our office performs limited reviews of selected contracts. During FY2005, 451 contracts were reviewed by the City Auditor's Office.

Citywide Training

During FY2005, we presented our *Fraud and Internal Control Issues for City Staff* Power Point presentation on internal controls and fraud prevention to 88 employees from several departments including:

- Finance- Customer Service,
- Purchasing,
- Information Technology, and
- Transportation.

The City Auditor's Office presented seven fraud trainings to City staff.

We surveyed the participants to determine the usefulness of the training. The majority of the respondents indicated they agreed or strongly agreed the information presented during this class was applicable to their job and would recommend this class to others. Most attendees recommend that all City staff receive this training.

The following quotes are taken from the FY2005 *Fraud and Internal Control Issues for City Staff* participant surveys. Participants' responses to "What concepts were most valuable" included:

- Learning concept of systems of control.
- The consequences for weak internal controls.
- Examples given of things to look for related to fraud as the "types" of fraud you wouldn't normally consider (i.e. abuse of sick leave).
- Knowing that you can go to someone other than your superior to report fraud.

IV. Looking Towards the Future

The implementation rate of our recommendations has significantly decreased over the past three years.

The Auditor's Office established, as a performance measure, that 40% of our recommendations should be either fully implemented or partially implemented (as reported by the City Manager) as of the issuance (Council date) of each of our audits. As seen on page 4 of this report, for fiscal year 2005, the reported rate was only 26%. This compares unfavorably with the 38% rate reported in 2004, and the 44% rate reported in 2003.

The City Auditor is responsible, by Government Audit Standards, for following up on the implementation of the audit recommendations. The City has been under increasing budgetary pressure to cut corners in terms of internal controls, in order to protect front line services. In order to address that risk, the auditors plan to spend increasing amounts of our resources to monitor the implementation of our recommendations for improvements.

We will also redouble our efforts to empower City staff to improve their management of City resources by providing training about the importance of management (internal) controls. In 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.