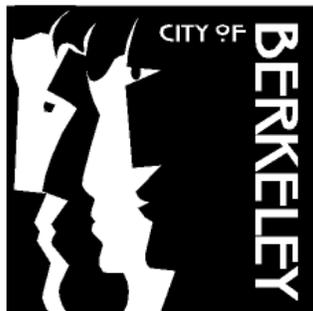


City of Berkeley



City Auditor's Annual Report For Fiscal Year 2004

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Presented to Council on November 9, 2004

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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 reports the results of audits and other investigations and reviews to Council, the City Manager, and Berkeley residents. Our office is considered to be independent because the City Auditor is elected. 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 Breland, Maio, and Wozniak.

Independent Auditors are a Good Investment

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

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.

City Management Recognizes Value

Council and the City Manager recognize the value of internal controls and accountability. They have demonstrated commitment to improvements within the organization by actively supporting implementation of our audit recommendations. The City Manager and the Council also supported an amendment to the City Charter, affirmed by vote of Berkeley residents, which strengthened the independence and accountability of the Auditor's Office by requiring adherence to Government Audit Standards.

Who are the Auditors?

The City's audit staff for fiscal year (FY) 2004 include auditors who have been awarded recognition as Certified Internal Auditors (CIA) and Certified Government Auditing Professionals (CGAP), a Certified Public Accountant (CPA), Master in Business Administration (MBA), and Master in Public Affairs (MPA):

City Auditor	Ann-Marie Hogan	CIA, CGAP
Audit Manager	Teresa Berkeley-Simmons	CIA, CGAP
Senior Auditor	Frank Marietti	CIA, CGAP
Auditor II	Jocelyn Nip	CPA
Auditor II	Abiud Amaro	MBA
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 Hughes, who also supports the Payroll Audit Division and monitors the Department's budget.

Our Cost vs the Cost to Outsource the Audit Function FY2004

Average cost of audit staff time during FY2004, including the budgeted amounts for administrative overhead, was substantially less than amounts we noted based on a sample of last year's City contracts for outside auditors and management consultants. This is one reason we encourage City management to contact us prior to outsourcing audit and management consulting work. Next year, with the support of the City Manager, we will be surveying all departments about plans to possibly contract out consulting work that could be performed by auditors, before finalizing our annual audit plan.

An additional 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.

Who Audits the Auditor?

The City Charter requires the City Auditor to conduct audits in conformance with government audit standards. 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.

The reviewers gave our office an unqualified favorable opinion. The Opinion Letter states, "We have concluded from our review that your system of internal quality control was suitably designed and provided reasonable assurance that applicable government auditing standards were followed in the audit work. We have also concluded from the sample of audits tested that your quality controls were working effectively and that audits were conducted in conformance with applicable standards during the period under review."

The Peer Reviewers complimented our office on the high quality of audit programs, successful communication with management during key phases of the audit, timeliness of audit report issuance, and management's high degree of acceptance of our audit recommendations.

What did our Auditees Say?

In order to ascertain the level of service provided by our department, we ask all auditees or anyone who contributed to the audit to complete a Quality Service Questionnaire. During FY2004, 83% of the respondents rated the overall process and results of the audit good or excellent.

The following quotes are taken from FY2004 Quality Service Questionnaires:

- [The auditor] was always pleasant and cheerful, and he listened well.
- I appreciate that we were given adequate opportunity to correct errors or misinformation in the draft report, and to note what items we had already addressed.
- I think the process was fair, illuminating, and constructive.

Key Performance Measures

Audits completed in accordance with Government Auditing Standards	100%
Number of high quality completed projects per fiscal year as a percent of plan*	73%
Number of recommendations issued	124
Number of recommendations accepted by auditee	100%
Number of recommendations implemented within two years	81%

*Includes Peer Review of the City of Berkeley Auditor's Office. Note: due to the hiring freeze required by the City's budget constraints, during FY2004 the Auditor's Office returned to the City's General Fund salary savings equivalent to almost two benefited staff positions. The savings was due to position vacancies. This had a negative impact on the completion of the year's audit plan, as well as generation of Business License revenue. However, there was a positive impact in avoiding layoffs of City staff during the year. The office was able to fill one of the vacant positions internally.

II. Audit Report Summaries

Here are 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, in one case, 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.

Transfer Station Cash Receipts/Cash Handling (Issued July 8, 2003)

As part of a series of cash handling audits placed on the 2003 and 2004 audit plan, at the request of the City Manager, an audit of the current cash receipts, handling, and deposit procedures and practices used by the Public Works Transfer Station at 1201 2nd Street was performed.

Most of the findings identified indicated that the Transfer Station staff were not placing enough emphasis on procedures designed to help ensure that all payments received at the Transfer Station are adequately safeguarded, deposited, and properly recorded.

Number of Recommendations Issued	20
Number of Recommendations Accepted by Auditee	20
Number of Recommendations Implemented or Partially Implemented Per Auditee as of 5/04/04	18

*City Manager's status report addressing the outstanding recommendations is scheduled to go to Council December 14, 2004.

Information Systems General Controls (Issued September 16, 2003)

At the request of the Director of Information Technology, an audit was performed to evaluate the adequacy of physical controls, inventory controls, environmental controls, access security and recovery planning for the City's information systems.

The increasing expansion of information technology capabilities allows easy and convenient use of information systems to originate, process, store, and communicate information. However, the ease and convenience come with new risks. Among these is the risk that valuable and confidential information may be lost, corrupted, misused or accessed by unauthorized persons. The City must minimize this risk by developing a flexible security strategy that adapts to the changing environment to protect the City's information resources.

Number of Recommendations Issued	27
Number of Recommendations Accepted by Auditee	27
Number of Recommendations Implemented or Partially Implemented Per Auditee as of 11/9/2004*	26

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

Accounts Payable (Issued December 16, 2003)

An audit was performed with the objective of identifying duplicate City payments made to vendors during FY2003.

The audit did not identify any significant loss of money from duplicate vendor payments, but did identify several causes for such payments. These causes should be resolved because they could allow larger future duplicate payments to occur and go undetected.

Number of Recommendations Issued	16
Number of Recommendations Accepted by Auditee	16
Number of Recommendations Implemented or Partially Implemented Per Auditee as of 10/19/2004*	10

* City Manager's status report addressing the outstanding recommendations is scheduled to go to Council March 22, 2005.

Business License Tax Program Audit Report for Fiscal Year 2003 (Issued April 27, 2004)

The report identified the Business License tax revenue identification efforts and accomplishments of the Auditor's Office during FY2003. Business License Tax Program audits resulted in 47 businesses being billed a total of \$393,295 during FY2003.

Between 1982 and 2003, auditors identified revenues totaling \$4,412,518. 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.

FUND\$ Change Management (Issued May 4, 2004)

This audit was performed to evaluate the adequacy of internal controls over program changes to FUND\$, the City's financial system. The audit found that internal controls over program changes to the City's financial system, FUND\$, were not adequate. There was no consistent application of methodologies in prioritizing projects due to the lack of citywide IT governance and formalized IT strategic goals.

Number of Recommendations Issued	23
Number of Recommendations Accepted by Auditee	23
Number of Recommendations Implemented or Partially Implemented Per Auditee as of 5/04/2004*	7

* City Manager's status report addressing the outstanding recommendations is scheduled to go to Council December 14, 2004.

Citywide Contract Compliance (Issued May 18, 2004)

The audit was performed to determine whether departments were in compliance with the City's competitive solicitation policies, determine the frequency of contract services being performed prior to contract execution, and determine whether contracts were executed or amended after the expiration of the contract.

The audit identified several areas of weakness in contract preparation by project managers, including lack of evidence of competitive solicitation and bidding in the contract packages, work starting prior to contract execution, executing and amending expired contracts, and use of vouchers and purchase orders to circumvent controls over contract spending limits.

Number of Recommendations Issued	18
Number of Recommendations Accepted by Auditee	18
Number of Recommendations Implemented or Partially Implemented Per Auditee as of 5/18/04*	6

* City Manager's status report addressing the outstanding recommendations is scheduled to go to Council January 25, 2005.

Berkeley Public Library Purchasing and Accounts Payable Audit (Issued June 8, 2004)

At the request of the Library Director and the Library Board of Trustees, this audit was performed to evaluate the effectiveness of the internal control structure over the purchasing and accounts payable operation in the Library's:

- a. Administrative Divisions and
- b. Order Unit (Located in the Technical Services Division)

The audit found that the internal control structure over the purchasing and accounts payable operation in both the Administrative Division and the Order Unit needed improvement. The audit also found that the Library appears to be taking steps to identify and correct safety concerns at the Central Library, a direct effort to help reduce the risk of worker's compensation claims.

Number of Recommendations Issued	20
Number of Recommendations Accepted by Auditee	20
Number of Recommendations Implemented or Partially Implemented Per Auditee as of 9/28/04	17

III. Other Program Services

Compliance Audit: Business License Tax

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. For FY2003 and 2004 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 1.3:1. This indicates that the cost/benefit may be greater for unlicensed than underreporting. However, continuous monitoring for underreporting is an important deterrent. In FY2004 our performance measure was \$125,000 per assigned employee. With 1 FTE (full time equivalent employee) assigned in this area, total amount assessed was \$125,070. Total amount collected was \$133,038. 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 must be countersigned and registered by the City Auditor. Our office performs limited reviews of selected contracts. During FY2004, 568 contracts were reviewed by the City Auditor's Office.

Citywide Training

During FY2004, we presented our *Fraud and Internal Control Issues for City Staff* Power Point presentation on internal controls and fraud prevention to 126 employees from several departments. 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 FY2004 *Fraud and Internal Control Issues for City Staff* participant surveys:

- Internal controls part of the presentation was very informative.
- I'll keep the [concepts] in mind when my duties change.
- Good class.
- Makes you think about what is going on in your unit and changes that are needed.
- I will pay more attention to internal controls in developing procedures.
- Helpful to educate staff so they can be aware of inappropriate behavior.
- GREAT!!

IV. Looking Towards the Future

The Auditor's Office continues to improve the effectiveness and efficiency of our audit work due to an emphasis on continuous learning and quality control, as well as new advances in audit software that enable us to sample much larger amounts of data with less investment of time. The powerful audit software tools which we began actively using at the end of the fiscal year will enable broader and more continuous audit coverage, more closely targeted auditing, and, in particular, the potential for identifying new revenue.

Perhaps more significantly, the City Manager and the City Council have helped us to craft increasingly strategic audit plans each year, based on what kind of information management needs in order to make improvements to City services.

Support from management and Council for timely and complete implementation of our audit recommendations has been a powerful force for change.

For the next few years, the City will be 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.