

Office of the City Auditor

INFORMATION CALENDAR

February 13, 2007

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 Annual Report for Fiscal Year 2006

SUMMARY

Attached is the City Auditor's Annual Report for Fiscal Year 2006. This report details accomplishments of the Performance Audit division and will be available on the City Auditor's website.

CURRENT SITUATION AND ITS EFFECTS

In FY06 the City Auditor's Office issued the following audit reports:

- Limited Tuolumne Camp Staff Review,
- Business License Tax Program Audit Report for Fiscal Year 2005,
- Follow-up Cash Receipts/Cash Handling Audit,
- Association of Sports Field Users, and
- Seniors and Disabled Home Rehabilitation Loan Program

Implementation of the recommendations made in these audits resulted in reduced risk, increased revenue, and better accountability for City assets and resources.

One of our audits, in which recommendations were brought forward to the Personnel Board as part of management's implementation, received the following praise from a Board member:

"The audit of Berkeley city camps is an example of good government at work. They are to be commended. The City Auditor and staff from Human Resources and Parks Departments all worked together to produce excellent recommendations, which will now be reviewed by the City Council. This is how government is supposed to work."

In addition, the City Auditor's Office was identified as a "Best Practices" shop in a survey conducted by the Association of Local Government Auditors.

In October 2006 our office received a peer review. We were awarded the highest rating possible for quality and professionalism.

The City Auditor's Office assessed \$44,002 in Business License tax revenue. Assigned to this area including supervisory time was .58 FTE (full-time equivalent employee). Due to position vacancies, the Performance Audit division spent over \$200,000 less than budgeted, and contributed an additional \$100,000 in salary savings for FY06. This significantly impacted revenue identification and other service delivery.

The City Auditor's Office also reviewed 432 contracts and selected payments, and we presented our *Internal Controls for City Staff: Safeguarding Assets, Preventing Fraud, and Measuring Performance* PowerPoint training to 191 employees. City employees are charged with the prudent stewardship of public resources. Our training increased awareness of every employee's responsibility to prevent misuse of City assets and to report indications of fraud or abuse.

POSSIBLE FUTURE ACTION

Next year we will examine the adequacy and accuracy of Business License data available in the City's computerized systems and other potential barriers to efficient revenue collection.

Fiscal difficulties will continue to inform our audit strategies. A major challenge for local governments will be state and federal structural deficits. A structural deficit exists when commitments for future expenses exceed prudent estimates of future revenues. If federal and state services are reduced, residents might expect local government to step in and provide replacement services. If federal and state grants are cut, direct services such as public health and safety, as well as capital funds for improvements, will suffer.

Council will make difficult choices to balance reductions in services and reductions in oversight and support. Our audit strategy will continue to address providing better information to decision makers as well as improving the ability of City staff to monitor the effective use of City resources through our training, consulting, follow-up work, and performance audits.

FISCAL IMPACTS OF POSSIBLE FUTURE ACTION

Through our audits, we expect to develop recommendations that will result in increased revenue and/or reduced costs in the long run.

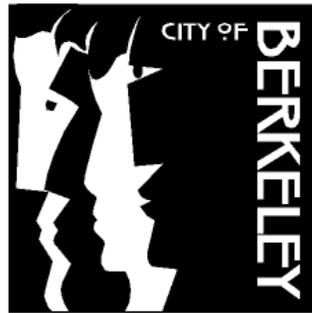
CONTACT PERSON

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Attachments:

- 1: City Auditor's Annual Report for Fiscal Year 2006
- 2: List of Audits With Outstanding Recommendations as of January 16, 2007

City of Berkeley



City Auditor's Annual Report For Fiscal Year 2006

Prepared by:

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Presented to Council on February 13, 2007

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City Auditor's Annual Report for Fiscal Year 2006
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I. Mission, Measurement, and Results

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. Performance audits provide unbiased assessments of the use of public resources. We analyze and report on whether intended results are achieved, how improvements in operations can be made, and whether public resources are being managed effectively and responsibly.

"Public sector governance includes activities that ensure a government's credibility, establish equitable provisions of services, and assure appropriate behavior of government officials – reducing the risk of public corruption."

--The Institute of Internal Auditors, *"The Role of Auditing in Public Sector Governance"*

Independent Auditors are a Good Investment

Audit work can lead to new revenue, cost recovery, and increased efficiency, which have an economic impact well beyond the audit department's annual budget. An independent performance audit department is an investment that benefits the City.

Measuring Quality: Who Audits the Auditor?

Berkeley's auditors have been in the forefront of the move to improve the quality and usefulness of audit work. The office has voluntarily undergone a rigorous peer review every three years since the early nineties. We asked the voters to amend the Charter in 1998, to require these peer reviews. The peer reviewers evaluated the results of our work, as well as the quality of our work.

Our most recent peer review was performed October 2006, facilitated by the Association of Local Government Auditors (ALGA). The reviewers awarded our office the highest rating possible for quality and professionalism and praised:

- The qualifications of our staff,
- Cost-effective use of internal training for professional development,
- The usefulness of our written policies and procedures, and
- Our commitment to following Government Audit Standards.

ALGA also conducts surveys of other audit shops. This year's survey reports our submission and those of other jurisdictions. Berkeley is a "Best Practices" shop in:

- Business Planning: Working with Audit Committee and/or Senior Management to Identify Major Issues
- Measuring Audit Results: Audit Effectiveness Questionnaire
- Measuring Audit Impact: Audit Report Follow Up
- Peer Reviews

In October 2006 the Council also adopted the Auditor's recommended changes to the Berkeley Municipal Code. The changes clearly spell out the duties of the office and the expectations Council and the public should have for audit effectiveness.

For recommendations to be most constructive, they should be directed at resolving the cause of identified problems, action oriented and specific, addressed to parties that have the authority to act, practical and, to the extent feasible, cost effective and measurable.

Government Auditing Standard 8.29

Key Performance Measures

The most important measure of an auditor's work is this: What changed for the better because we were here?

A significant benefit of performing 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 implementation of the recommendations made.

First, we measure agreement with/acceptance of our recommendations. Results: we have continued to exceed our performance measure of a 95% acceptance rate.

Secondly, we measure impact: the percent of audit recommendations implemented timely (before the report goes to Council). This tells us "what changed" and also whether we communicated well in the early stages of the audit so that management could take prompt action. Our goal is a 40% implementation rate at the time the audit goes to Council.

Results: timely implementation of our recommendations during fiscal year 2006 continues to lag past performance (and other jurisdictions), at 26%. In 2002 and in 2003 staff implemented about 60% of the recommendations before report publication; in 2004, 37%.

Of course, 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. The decline since 2003 could also be linked to budget reductions.

Though timely implementation was slowing, the percent implemented within one year or two years has shown improvement, probably in response to actions taken by the City Manager, which he reported to Council on May 16, 2006. According to his report, the budget cuts and freezes that have been an unfortunate fact of life at the City beginning in fiscal year 2003 may play a part in staff's inability to timely improve conditions found in our audits. This report can be viewed at:

<http://www.ci.berkeley.ca.us/citycouncil/2006citycouncil/packet/051606/2006-05-16%20Item%2047%20Citywide%20Audit.pdf>

Performance Measures for FY04, FY05, and FY06			
	FY 04	FY05	FY06
Number of completed audits per fiscal year as a percent of plan	73%	50%	71%
Percent of recommendations accepted by auditee (goal: 95%)	100%	97%	100%
Percent of recommendations reported implemented or partially implemented by operating departments before report issued (goal: 40%)	37%	26%	26%
Percent of recommendations reported implemented or partially implemented by operating departments within one year (goal: 65%)	61%	79%	91%
Percent of recommendations reported implemented or partially implemented by operating departments within two years (goal: 95%)	81%	96%	91%

Citywide Challenges in 2006

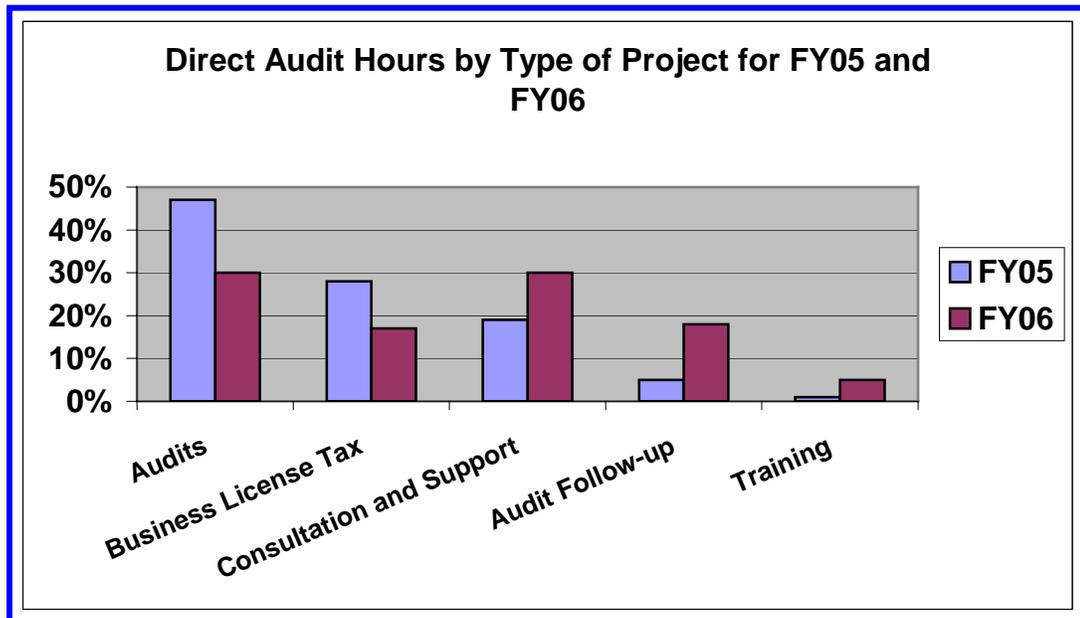
Several years of budget cuts which reduced staffing in oversight and support functions, combined with a hiring freeze and a practice of “bumping” employees into vacant positions had evident impacts Citywide, as well as in our office.

These risks and impacts are addressed in our reports, “Internal Control Risks Associated with Budget Cuts and Freezes” December 9, 2003, and “Delayed Implementation of Audit Recommendations” December 13, 2005. These can be viewed at <http://www.cityofberkeley.info/auditor/currentaudits.htm>. It seems reasonable that, as the City Manager reported, a slowdown in implementing recommendations is partly due to the inefficiency of employee turnover coupled with reduced staffing. Although this situation was expected to improve with the more stable 2007 budget, anticipated across the board reductions in fiscal years 2008 and 2009 are cause for concern. The three year performance measure trend for “recommendations implemented” reflects difficulties the whole City is experiencing. The three-year trend for “completed audits”, and for Business License Tax audit revenue, may reflect the impact of position reductions, vacancies, and turnover on the City Auditor’s staff.

Between 2003 and 2006 two of the three entry-level audit positions were eliminated from the budget (29% of the performance audit staff of seven). Like others in the City, the auditors found that not only the reductions but the turnover in staff meant that time was spent in training and re-organizing, rather than direct service. This had a negative impact on revenue generation in the business license area, as expected, as well as on the completion of planned performance audits. As planned, savings from our vacant positions (amounting to over \$200,000, in addition to \$100,000 in budgeted salary savings) were returned to the City treasury for use in balancing the budget in 2006.

2006 Audit Response to Changing Conditions

The difficulties City staff were having with implementation of our recommendations caused us to make some changes in our allocation of staff time in 2006. For the short term, we decided that we would spend less time performing audits, and more time giving City staff the guidance needed to implement change. We spent more time training – especially in Internal Controls and Fraud Prevention-, consulting, and follow-up monitoring and reporting.



II. Audit Reports

"The audit of Berkeley city camps is an example of good government at work. They are to be commended. The City Auditor and staff from Human Resources and Parks Departments all worked together to produce excellent recommendations which will now be reviewed by the City Council. This is how government is supposed to work."

*Isaiah Roter,
Berkeley
Personnel
Board*

Limited Tuolumne Camp Staff Review (Issued March 7, 2006)

[http://www.ci.berkeley.ca.us/auditor/pdf/TuolumneConsent6\(ARWS2\).pdf](http://www.ci.berkeley.ca.us/auditor/pdf/TuolumneConsent6(ARWS2).pdf)

This performance review was conducted to determine whether the work arrangement for two City employees was appropriate. The realized savings of implementing one of our recommendations was about \$6,500 each camp season. The auditors made five recommendations. Human Resources and the Parks Department planned significant changes to personnel procedures and practices for the camps as a result of our audit.

Business License Tax Program Audit Report for Fiscal Year 2005

(Issued April 25, 2006)

<http://www.ci.berkeley.ca.us/auditor/pdf/BLT%20Audit%20for%20FYEnded%206-30-05.pdf>

This report identified the Business License Tax revenue audit efforts and accomplishments of the Auditor's Office during fiscal year 2005. All audits initiated during fiscal year 2005 were audits of Berkeley residential rental properties. Business License Tax audits resulted in 13 businesses being billed a total of \$156,862 during fiscal year 2005. This amount includes a \$47,368 assessment that was referred to Finance for collections and a \$68,134 assessment that was appealed. Subsequently, the City Manager and the appellant entered into a written settlement. The City agreed to waive claims to the entire \$68,134; however, the appellant will be paying approximately 80% more in tax each year in the future.

Follow-up Cash Receipts/Cash Handling Audit (Issued May 16, 2006)

<http://www.ci.berkeley.ca.us/auditor/pdf/5-16Follow-up%20CashReceipts.pdf>

This audit looked at ten prior year audit recommendations from three cash receipts/cash handling audits issued during fiscal years 2003 and 2004. The auditors also performed surprise cash counts in Finance-Treasure and Finance –Customer Service. The audit included seven recommendations for reducing risk to the City's liquid assets.

Association for Sports Field Users (Issued May 23, 2006)

<http://www.ci.berkeley.ca.us/auditor/pdf/Association%20for%20Sports%20Field%20Users.pdf>

On March 1, 2001, the Parks, Recreation and Waterfront Department entered into a contract with the Association for Sports Field Users (ASFU). The contract obligated ASFU to maintain the two Gabe Catalfo fields and the field house in Harrison Park. The contract authorized ASFU to use the Gabe Catalfo field user fees; fees the City would normally receive, to maintain the fields. Our audit examined ASFU's compliance with the financial and accounting aspects of the contract. As a result of our audit and its thirteen recommendations, Parks staff decided to revise the new contract with ASFU.

As of January 1, 2007, there were 19 audits with a total of 104 outstanding recommendations. All of these audits have scheduled City Manager's response report back to Council dates.

Seniors and Disabled Home Rehabilitation Loan Program (Issued May 23, 2006) <http://www.ci.berkeley.ca.us/auditor/pdf/SDHRLP%20program.pdf>

This performance audit reviewed loans for compliance with the City's program guidelines, CDBG requirements, and CalHome requirements. We evaluated internal controls focusing on eligibility determination, program assistance, disbursements, record keeping, and program monitoring and oversight. The report included twenty-three recommendations for improvement.

III. Revenue, Oversight, and Training

Revenue Audits: Business License Tax (BLT)

Between 1982 and 2006 auditors have billed tax, penalties, and interest totaling \$4,740,350. 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.

Contracts

The City Charter requires that all contracts be countersigned and registered by the City Auditor. Our office performs limited reviews of selected contracts and payments. During fiscal year 2006, 432 contracts were reviewed by the City Auditor's Office.

Citywide Training

During fiscal year 2006 we presented our *Internal Controls for City Staff: Safeguarding Assets, Preventing Fraud, and Measuring Performance* Power Point training on internal controls and fraud prevention to 191 employees. Between fiscal years 2003 and 2006 the City Auditor's Office trained 403 employees in fraud prevention and internal controls. City employees are charged with the prudent stewardship of public resources. Our training provides awareness of every employee's responsibility to reduce the risk of improper or inefficient use of City resources, and to report indications of fraud or abuse.

IV. Looking Towards the Future

“Auditors should engage in oversight, insight, and foresight work. As the country’s lead accountability agency, the GAO has undertaken the task of informing the Congress and the citizens of the United States about the serious financial challenges we face.”

from “*Saving Our Future Requires Tough Choices Today*,” Atlanta Rotary Club address by the Honorable David M. Walker, comptroller general of the United States, June 12, 2006

One of the major challenges for local governments, and for their auditors, is the extent to which structural deficits exist at the federal and state levels, regardless of conditions in an individual locality. A structural deficit exists when commitments for future expenses exceed estimates of future revenues.

Deficits at the state and federal level, resulting in likely reductions in state and federal assistance and services, can be expected to negatively impact the City of Berkeley for the foreseeable future. If federal and state services are reduced, residents might expect local government to step in and provide replacement services. If federal and state grants are cut, direct services such as public health and safety, as well as capital funds for improvements, will suffer.

For more information about the prospects for continued shrinkage of state resources in California, the reports from the nonpartisan California Legislative Analyst are illuminating. “California Spending Plan 2006-07: The Budget Act and Related Legislation” and other reports can be found on her website at www.lao.ca.gov. The California Budget Project at www.cbp.org is another resource for monitoring trends at the State level.

U.S. Comptroller General David Walker has undertaken a major public education campaign on the subject of the long-term federal structural deficit. An excellent resource that links his presentation to the problems of individual cities is a report by former Kansas City Auditor Mark Funkhouser. It can be viewed on his web site at <http://www.kcmo.org/auditor/05-06audits/financialfutureforum.pdf>

The City has implemented budget reductions for several years, aimed at closing the gap between income and expenditures. City staff are currently under increasing budgetary pressure to cut corners in terms of internal controls, in order to protect front line services and balance the budget.

Given the expected budget pressures, our audit strategy continues 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 also attempt to provide information, through our audits, that will assist Council in decision-making.

To address the risk of shortchanging prudent internal controls, the auditors will continue to allocate substantial Performance Audit resources towards monitoring the implementation of our recommendations for improvements.

We will also redouble our efforts to empower City staff 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 and programs, resources and risk.

**Open Audit Status Report
As of
December 31, 2006**

	Audit Title	First Council Report Date	Return to Council Date
1	Audit of the Association of Sports Field Users	May 23, 2006	July 17, 2007
2	Senior and Disabled Home Rehabilitation Loan Program	May 23, 2006	September 18, 2007
3	Follow-up Cash Receipts/Cash Handling Audit	May 16, 2006	May 22, 2007
4	Limited Tuolumne Camp Staff Review	March 7, 2006	June 26, 2007
5	Parcel Based Special Taxes, Fees, and Assessments Audit	March 15, 2005	July 17, 2007
6	Purchase Order Audit – Select Public Works Division at the Corporation Yard	March 15, 2005	December 4, 2007
7	Citywide Contract Compliance Audit	May 18, 2004	December 4, 2007
8	FUND\$ Change Management Audit	May 4, 2004	April 24, 2007
9	Accounts Payable Audit	December 16, 2003	April 24, 2007
10	Information Systems General Controls Audit	September 16, 2003	April 24, 2007
11	Customer Service Cash Receipts/Cash Handling	April 8, 2003	May 22, 2007
12	Cash Receipts/Cash Handling Audit – Parks Recreation and Waterfront	September 17, 2002	May 22, 2007
13	Cash Receipts/Cash Handling Audit - Treasury	September 17, 2002	May 22, 2007
14	Police Staffing	April 30, 2002	May 2008
15	Business License Tax Audit Report for Year Ending June 30, 1999	April 11, 2000	May 22, 2007
16	Departmental Budget Monitoring Audit	November 23, 1999	April 24, 2007
17	Safety Members Pension Fund for the Year Ended June 30, 1998	April 20, 1999	April 24, 2007
18	Public Works Grants Audit	September 16, 1997	April 24, 2007
19	Review of Residential Rental Inspection Program	March 11, 1997	June 26, 2007

