



Office of the City Auditor

INFORMATION CALENDAR

June 23, 2015

To: Honorable Mayor and Members of the City Council
From: Ann-Marie Hogan, City Auditor
Subject: Audit Follow-up Status Report

SUMMARY

Berkeley is a better place because of efforts to implement our audit recommendations. City staff recently finalized action on our [Public Works Grants Audit](#),¹ as reported on [5/12/15](#),² and our report [Payment Card Acceptance Audit: Is Cardholder Information Safe?](#),³ as reported on [5/26/15](#).⁴ By taking action, staff took the necessary steps to:

- Improve timeliness of grants billing and help secure future grant funding
- Increase cash flows from and interest earned on grant revenue
- Protect customer information
- Prevent payment-card fraud
- Avoid fines for noncompliance with privacy regulations

Taking those steps demonstrated City staff's commitment to implementing the 65 audit recommendations that we reported as open as of [June 30, 2014](#).⁵ Unfortunately, barriers to change hinder their progress: FUND\$ system shortcomings, new software installations, and loss of skilled staff have all reduced City staff's ability to fully implement our audit recommendations.

Two years ago, the City Manager made it a high priority to have City management implement our older recommendations. City staff responded by closing eight audits before the start of the 2014 fiscal year. In her report, [Update on Outstanding Audits](#), the City Manager described staff's efforts to close those recommendations and their plans to address items still requiring management's attention.⁶ Since then, City staff closed two of our audits and implemented eighteen recommendations. This includes eight new recommendations from the audits we issued this year.

CURRENT SITUATION AND ITS EFFECTS

We made 32 new recommendations this fiscal year to help improve City operations, promote transparency and accountability, and deter fraud. Staff took immediate action and implemented eight of those recommendations. They also addressed ten recommendations from our older audits. The following describes City staff's efforts and the challenges they must overcome to implement the 78 audit recommendations open as of June 23, 2015:

Audits Closed in Fiscal Year 2015

City staff successfully closed two audits this year by implementing our recommendations to provide training and written guidance that will allow City staff to secure grant funding and earn interest on that money, and meet industry standards to protect payment card customer information:

[Public Works Grants Audit⁷](#)

When we completed this audit in 1997, the City's grants receivable balance was more \$9 million. Over \$3 million in related expenditures were eligible for billing against that balance, but had not, in fact, been billed. Public Works alone lost nearly \$120,000 in interest on over \$2 million of uncollected funds for two of its grants. The problems leading to that loss were not isolated in Public Works; they were citywide. We found that a lack of accountability, ineffective systems, undocumented procedures, and little to no training led to delayed billing and loss of interest income. Project managers specifically identified the City's financial system (FUNDS) as an ineffective tool for managing large, multi-year, multi-fund capital projects.

Finance worked hard over the last several years to provide training, written procedures, and accountability mechanisms for citywide grants billing. This led to a \$4.4 million decrease in the use of General Funds to cover grant revenue shortfalls: Finance reported in the City's proposed 2016-2017 budget book that use of General Funds cash to make up for the revenue shortfall decreased from \$6.8 million in fiscal year 2012 to \$5.3 million in 2013 and to \$2.4 million in 2014. Better guidance on monitoring grants also resulted in a sharp reduction in findings in the annual Single Audit, reducing the risk of loss of future grant funding.

[Audit of Citywide Payment-Card Acceptance: Is Cardholder Information Safe?⁸](#)

In our 2011 audit, we found that cardholder information was not safe. We also found that Finance was no longer providing the citywide cash-handling training that we recommended in our earlier audits. Therefore, to protect cardholders, we recommended that Finance provide guidance to departments about safeguarding customer information, and that departments improve security over that information. We also recommended establishing a plan and targets for conducting cash-handling training and surprise cash counts. By implementing all of the audit recommendations, the City took the necessary steps to protect customer privacy, avoid fines for noncompliance with laws, and reduce the risk of payment-card and other fraud.

Progress on Open Audits Reported This Year

City staff took action and implemented eighteen audit recommendations this year. They also continue to work towards closing the 78 recommendations that remain open, including 15 recommendations that have been open for over three years. FUNDS system shortcomings, new software installations, and loss of skilled staff have slowed their progress. Despite those setbacks, they made some progress on four of our audits and reported those efforts to Council this year:

[Construction Permits: Monitor Performance and Fee Assessments to Ensure Excellent and Equitable Customer Service](#)⁹

We found that Planning must address customer service needs more systematically, and that the City was taking unnecessary risks with cash and customer credit-card information. We recommended that Planning establish performance measures, maintain accurate performance information, and improve technology, records handling, and permit/project valuation. The City Manager reported on [5/26/15](#) that Planning made our suggested improvement to valuation, and, as a result, the City will gain \$300,000 in recurring revenue.¹⁰ Full implementation of most of our recommendations depends on installation of new Accela software, which is incomplete. However, the City Manager reported to Council on [4/7/2015](#) that Planning established plan check turnaround goals and customer wait-time goals, and built recommended requirements into the plans for the architecture and functionality of Accela.¹¹

[\\$52,000 Theft: More Can Be Expected Without Citywide Changes in Culture and Procedures, and Waterfront Cash Handling Report](#)¹²

We found significant weaknesses in how City staff handle cash and that these weaknesses led to the theft of Marina funds. We quantified the amount stolen by a former employee and made recommendations to dedicate resources to improve accountability, procedures, training, and systems.

Based on the weaknesses that allowed the theft to occur, we recommended these preventive and detective measures:

- Avoid giving employees the ability to both review and approve accounting entries.
- Purchase and implement centralized cashiering software to identify and prevent inappropriate employee access, as well as increase efficiency.
- Perform revenue trend analysis to look for unexpected changes and investigate anomalies.

Management submitted two reports to Council this year on the status of our cash-handling recommendations: [10/28/14](#) and [4/28/15](#).¹³ The City Manager reported that management took action on 11 of our recommendations. The City now has new cash-handling guidance and requirements to help safeguard City assets, including rigorous and timely revenue trend analysis to identify possible problems. Management is still working on citywide improvements, which includes the plan to automate cash handling and identify and avoid inappropriate computer access. The City Manager intends to report back to Council in October 2015 on management's progress with our cash-handling recommendations.

[Injury Prevention: Better Investigations and Data Use will Help the Berkeley Police Department and the City](#)¹⁴

The Police Department follows many best practices for preventing workplace injuries. To assist with their efforts to protect employees from harm, we found opportunities for improvement within the department as well as citywide. We recommended:

- Streamlined data-sharing
- Improved coordination within the Police Department and with Human Resources
- Formalization of the Police Department's employee wellness plan
- Citywide written guidance for injury investigations

The City Manager reported to Council on [4/28/2015](#) that the Police Department had refined their data collection, integrated duplicative databases, improved their ability to use data to monitor trends and prevent injuries, and continues to work on improving and formalizing its employee wellness program.¹⁵ The City Manager also reported that Human Resources is working to improve citywide written guidance for injury and illness investigations. The City Manager plans to report back to Council in October 2015 on management's progress on our recommendations.

[Equipment Replacement Fund –Sustainability and Transparency](#)¹⁶

We found an equipment replacement backlog of \$3.6 million, inaccurate records, insufficient monitoring of equipment, and lack of communication with users in other departments. Opportunities to reduce repair costs by disposing of old equipment and backup equipment were also not addressed, despite recommendations in an earlier audit. The City Manager reported to Council on [4/28/2015](#) that Public Works took action by improving their system for charging departments for expected vehicle replacements, and reducing the equipment replacement backlog.¹⁷ The City Manager will report back to Council in April 2016 on the remaining recommendation to increase the equipment replacement reserve fund.

Future City Manager Reports to Council on Open Audits

In keeping with efforts to provide Council with timely information, the City Manager has plans to submit two first-time status reports in this calendar year, with updates on two of our most recent audits:

[Underfunded Mandate: Resources, Strategic Plan, and Communication Needed to Continue Progress Toward the Year 2020 Zero Waste Goal](#)¹⁸

We found that the City is at risk of not meeting Council's goal to achieve zero waste by 2020. Public Works needs more resources to develop a comprehensive, written strategic plan. To achieve the City goal, we recommended that the department include objectives and short-term goals, actions and budget, planned timelines, assignment of responsibility, and performance measures in its annual work plan. Public Works plans to hire a new Zero Waste Manager and to submit a follow up report December 1, 2015.

[Written Guidance and Improved Monitoring can Help Prevent Unnecessary Overtime at the Animal Shelter and Help Manage Citywide Comp Time](#)¹⁹

Animal Shelter management successfully reduced overtime during fiscal year 2014. To keep costs from climbing again, we recommended that they monitor their overtime budget, adjust staffing schedules, and document and enforce their methods for managing overtime. In keeping with our goal to make citywide improvements when our department-specific audits allow us to do so, we examined the City's \$1.2 million for compensatory time liability during our assessment of the Animal Shelter's comp-time balance. We found that the City would benefit by providing departments with information about the hidden cost of using comp time to avoid overtime, and how to control future costs.

City Manager Status Reports Needed on Older Audits

The City Manager did not report to Council this year on management's progress on seven of our older audits. The biggest risk exposures that we identified in our older audits are associated with our outstanding recommendations from our 2012 Business License Taxes (BLT) audit, and our 2003 Customer Service and Treasury cash-handling audits. Delays in implementing our BLT audit recommendations are likely due to unusual employee turnover and software-installation difficulties. Although management is working to overcome those hurdles, the results are lost revenue and less than optimal customer service. The major delay in implementing two of the cash-handling audit recommendations is due to a FUND\$ system flaw that prevents management from limiting system access. This leads to unacceptable risk exposure as staff are given incompatible access so that they can perform their work. Such access levels allow for and could hide fraud. Staff are implementing measures to reduce the risk.

[Business License Taxes: Providing Better Guidance and Customer Service Will Increase Revenues](#)²⁰

We found that Business License guidance was insufficient and inconsistently applied, efforts to collect delinquent tax were ineffective, and that timely and persistent collection efforts could generate an additional \$90,000 each year. Specifically, we found these inefficiencies and fraud risks:

- Lack of reconciliation
- Insufficient supervisory review of adjustments
- Performance of incompatible duties

These are problems we have identified as citywide concerns. Incompatible duties are often due to staff shortages and exacerbated by a major flaw in the City's financial systems, FUND\$. Because of the software's shortcomings, supervisors cannot readily determine what computer access employees have. This heightens the risk of fraud. To reduce the risk, staff are implementing mitigating measures to monitor FUND\$ use.

The City Manager reported to Council on [6/24/2014](#) that Finance had implemented our recommendations to amend the Berkeley Municipal Code and revised customer forms to provide clearer guidance.²¹ Management also began to install new software (Accela)

and setup the new software to calculate taxes, penalties, and interest properly, and to eliminate one particular fraud risk of the FUND\$ software that allowed staff to delete records. Finance cannot implement our other recommendations, such as moving to an online application and payment of taxes, until the conversion from the City's FUND\$ Occupational License software to Accela is complete. In addition to those needed improvements, our recommendations to develop performance measures, monitoring reports, and written guidance, and to pursue collection efforts by contracting with a collection agency, remain outstanding. The City Manager plans to report back to Council in October 2015 on management's progress with those items.

[Treasury – Cash Receipts / Cash Handling Audit](#)²² and [Customer Service Cash Receipts / Cash Handling Audit](#)²³

Open recommendations from our 2003 cash-handling audits are now over a decade old. Both Finance and Information Technology staff have been working to implement our recommendations to limit and monitor FUND\$ access. The FUND\$ system architecture, however, prevented them from fully implementing our recommendations. Therefore, to address the fraud risks that we discussed in our reports, staff implemented mitigating measures to monitor FUND\$ use. Although these measures do not provide information about the full FUND\$ access that employees must have in order to perform their work, they do provide a means to reduce the fraud risks. The City Manager last reported to Council on the status of these reports on May 6, 2008²⁴ and plans to issue an update this fall to inform Council of the alternatively implemented access review process.

[Audit: City Fuel Operations Need Improvement](#);²⁵ [Public Works Contract Monitoring: Risk of Overpayments / Lack of Inventory Controls](#);²⁶ and [Purchase Order Audit – Select Public Works Divisions at the Corporation Yard](#)²⁷

These three Public Works audits hinge on a single item: improving the City's inventory controls. According to the City Manager, in order to properly staff this function, the City needs to reclassify at least one position to an appropriate job classification to manage the parts inventory. To improve inventory oversight in the interim, Public Works reported that the department moved the Facilities Maintenance Division from the Transfer Station to the Corporation Yard where inventory is kept. Once the position is reclassified, the City can move forward with filling the new position and implementing the inventory control system for which the employee will be responsible. This should address our inventory control recommendations and close the audit. We first reported our concerns over inventory control in 2005 and then again in 2010 and 2011:

- Fuel Operations (4/26/11): last status report [3/19/13](#)²⁸
- PW Contracts Monitoring (2/9/10): last status report [1/22/13](#)²⁹
- Purchase Orders (9/29/15): last status report [12/11/12](#)³⁰

The City Manager plans to report to Council in September 2015 on management's progress with our recommendations to improve inventory controls.

[Leases Audit: Conflicting Directives Hinder Contract Oversight](#)³¹

Management has delayed implementation of the remaining recommendations as they work to fill a vacancy in a key property-management position. Meanwhile, staff are exploring alternate methods to address our concerns. The City Manager last reported to Council on the status on [November 12, 2013](#).³²

ENVIRONMENTAL SUSTAINABILITY

Many of our audit recommendations include replacing manual and paper-based systems with electronic alternatives.

POSSIBLE FUTURE ACTION

Council initiatives and audit recommendations trigger staff costs that are not always clearly visible. Council must continue to balance public demand for new programs and increased direct services with the need to invest resources in the systems that support services and service improvements. This may include short-term reductions to some programs to achieve long-term efficiencies and risk reduction for all programs. One example would be the need to set aside larger reserves or to pursue additional financing to replace the City's aging fiscal and performance software, FUND\$.

FISCAL IMPACTS OF POSSIBLE FUTURE ACTION

The major cost to address our recommendations involves replacing FUND\$. In 2010, the City Manager estimated the cost of replacement of all FUND\$ modules at over \$7 million. The City Manager and Council wisely instituted a practice of setting aside \$500,000 a year for that purpose. This is not enough to replace the system timely. Numerous audits of software installations in other cities point to the importance of fully funding the planning phase of systems conversion. That will require hiring staff to backfill for the City's employee subject-matter experts for several years, and the cost will likely be significantly more than the 2010 estimate. Considerations include:

- There are fewer highly experienced staff to complete analysis and implementation work due to retirements and budget cuts
- Some current staff are less familiar with business processes
- Staffing costs have increased because of unprecedented growth in health care and retirement costs

The return on investment? Badly needed increased efficiencies and reduced fraud risk.

CONTACT PERSON

Ann-Marie Hogan, City Auditor
City Auditor's Office 510-981-6750

Full listing of our referenced audits and City Manager status reports:

- ¹ http://www.cityofberkeley.info/uploadedFiles/Auditor/Level_3_-_General/PWGrantsAuditreport1-6-98.pdf
- ² http://www.cityofberkeley.info/Clerk/City_Council/2015/05_May/Documents/2015-05-12_Item_31_Audit_Implementation.aspx
- ³ http://www.ci.berkeley.ca.us/uploadedFiles/2011-05-31_Item_27_Audit_of_Citywide_Payment-Card_Acceptance_Is_Cardholder_Information_Safe.pdf
- ⁴ http://www.cityofberkeley.info/Clerk/City_Council/2015/05_May/Documents/2015-05-26_Item_36_Audit_of_Citywide_Payment.aspx
- ⁵ http://www.cityofberkeley.info/uploadedFiles/Auditor/Level_3_-_General/A.2_RPT_2013%202014%20Annual%20Report_Final_090914.pdf
- ⁶ http://www.ci.berkeley.ca.us/Clerk/City_Council/2014/06_Jun/Documents/2014-06-03_Item_35_Update_on_Outstanding_Audits.aspx
- ⁷ http://www.cityofberkeley.info/uploadedFiles/Auditor/Level_3_-_General/PWGrantsAuditreport1-6-98.pdf
- ⁸ http://www.ci.berkeley.ca.us/uploadedFiles/2011-05-31_Item_27_Audit_of_Citywide_Payment-Card_Acceptance_Is_Cardholder_Information_Safe.pdf
- ⁹ http://www.cityofberkeley.info/uploadedFiles/Auditor/Level_3_-_General/A.1_RPT_Audit%20Report_Final_032514.pdf
- ¹⁰ http://www.cityofberkeley.info/Clerk/City_Council/2015/05_May/Documents/2015-05-26_Item_31j_Building_Valuation.aspx
- ¹¹ http://www.cityofberkeley.info/Clerk/City_Council/2015/04_Apr/Documents/2015-04-07_Item_40_Audit_Update_Construction.aspx
- ¹² http://www.cityofberkeley.info/uploadedFiles/Auditor/Level_3_-_General/A.2_RPT_PRW%20Cash%20Handling_Final.pdf
- ¹³ http://www.cityofberkeley.info/Clerk/City_Council/2014/10_Oct/Documents/2014-10-28_Item_18_Audit_Implementation_Status.aspx; *and*
http://www.ci.berkeley.ca.us/Clerk/City_Council/2015/04_Apr/Documents/2015-04-28_Item_41_Audit_Implementation.aspx
- ¹⁴ http://www.cityofberkeley.info/uploadedFiles/Auditor/Level_3_-_General/A.2_RPT_Police%20Injuries_Final.pdf
- ¹⁵ http://www.cityofberkeley.info/Clerk/City_Council/2015/04_Apr/Documents/2015-04-28_Item_43_Audit_Response_-_Injury.aspx
- ¹⁶ http://www.cityofberkeley.info/uploadedFiles/Auditor/Level_3_-_General/2010-10-26_Item_15_Audit_Equipment_Replacement_Fund_T_Sustainability_and_Transparency.pdf
- ¹⁷ http://www.cityofberkeley.info/Clerk/City_Council/2015/04_Apr/Documents/2015-04-28_Item_44_Status_Report_Equipment.aspx
- ¹⁸ http://www.cityofberkeley.info/uploadedFiles/Auditor/Level_3_-_General/A%202_RPT_Zero%20Waste_Final.pdf
- ¹⁹ http://www.cityofberkeley.info/uploadedFiles/Auditor/Level_3_-_General/A.2_RPT_Animal%20Shelter%20Overtime%20and%20Staffing_Citywide%20Comp%20Time_Final.pdf
- ²⁰ [http://www.cityofberkeley.info/uploadedFiles/Auditor/Level_3_-_General/BLT%20Revenue%20Collection%20Audit_Final\(1\).pdf](http://www.cityofberkeley.info/uploadedFiles/Auditor/Level_3_-_General/BLT%20Revenue%20Collection%20Audit_Final(1).pdf)
- ²¹ http://www.cityofberkeley.info/Clerk/City_Council/2014/06_Jun/Documents/2014-06-24_Item_58_Audit_Update_-_Business_License.aspx
- ²² http://www.cityofberkeley.info/uploadedFiles/Auditor/Level_3_-_General/TeasCashAudietReport9-17-02.pdf
- ²³ http://www.cityofberkeley.info/uploadedFiles/Auditor/Level_3_-_General/CustServReport4-8-03.pdf
- ²⁴ http://www.ci.berkeley.ca.us/uploadedFiles/Clerk/Level_3_-_City_Council/2008-05-06_Item_45_Treasury_Cash_ReceiptsCash_Handling_Audit_2013_Status_Report.pdf *and*

http://www.ci.berkeley.ca.us/uploadedFiles/Clerk/Level_3_-_City_Council/2008-05-06_Item_43_Customer_Service_Cash_Receipts.pdf

²⁵ http://www.ci.berkeley.ca.us/uploadedFiles/Clerk/Level_3_-_City_Council/2011/04Apr/2011-04-26_Item_37_Audit_City_Fuel_Operations_Need_Improvement.pdf

²⁶ http://www.cityofberkeley.info/uploadedFiles/Auditor/Level_3_-_General/2010-02-09_Item_09_Audit_Report_Public_Works_Contract_Monitoring.pdf

²⁷ http://www.cityofberkeley.info/uploadedFiles/Auditor/Level_3_-_General/PurchasingFinalRpt71.pdf

²⁸ http://www.ci.berkeley.ca.us/Clerk/City_Council/2013/03Mar/Documents/2013-03-19_Item_42_Status_Report_City_Fuel.aspx

²⁹ http://www.cityofberkeley.info/Clerk/City_Council/2013/01Jan/Documents/2013-01-22_Item_23_Status_Report_Public_Works.aspx

³⁰ http://www.ci.berkeley.ca.us/Clerk/City_Council/2012/12Dec/Documents/2012-12-11_Item_31_Status_Report_Purchase_Order_Audit.aspx

³¹ http://www.cityofberkeley.info/uploadedFiles/Auditor/Level_3_-_General/2009-06-02_Item_16_Leases_Audit_Conflicting_Directives_Hinder_Contract_Oversight.pdf

³² http://www.ci.berkeley.ca.us/Clerk/City_Council/2013/11Nov/Documents/2013-11-12_Item_21_Status_Report_Leases_Audit.aspx