

Office of the City Auditor

CONSENT CALENDAR
March 15, 2005

To: Honorable Mayor and
Members of the City Council

From: Ann-Marie Hogan, City Auditor

Subject: Purchase Order Audit – Select Public Works Divisions At the Corporation Yard

RECOMMENDATION

We are asking Council to request the City Manager to report back on September 13, 2005 regarding the implementation status of each of the City Auditor's recommendations in the attached report, and continue to report back every six months thereafter, until all recommendations have been implemented.

SUMMARY

A performance audit was performed to:

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

The audit report contains eleven audit findings and twenty-three recommendations.

FISCAL IMPACTS OF RECOMMENDATION

The audit did not look at the cost to implement the audit recommendations. However, care was taken not to make audit recommendations that did not appear cost effective to implement.

CURRENT SITUATION AND ITS EFFECTS

Concerns identified during the audit include the following:

- The City Purchasing Manual, which is maintained by the Finance Department, is very outdated. (Finding 1)

- There are a number of managers, supervisors, and other employees in the Equipment Maintenance and Streets and Utilities Divisions that can perform one or more incompatible purchasing related duties. (Finding 2,10) Additionally, a couple of employees have not been properly authorized to perform some of their purchasing duties. (Finding 7,10)
- A senior supervisor gave his FUNDS\$ password to a subordinate supervisor, which gave the subordinate supervisor the ability to perform incompatible duties, such as review and approve some of his own work, under his supervisor's ID. (Finding 2)
- The 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. (Finding 4,5) Additionally, procedures are not in place that provide a reasonable assurance that Equipment Maintenance is being reimbursed by other departments for the parts and outside service purchases it buys to repair their equipment. (Finding 6)
- Sufficient competitive pricing, or price negotiation, is often not obtained before a purchase order is issued for Equipment Maintenance. (Finding 3)
- The monthly documented safety inspections required by the City's Illness and Injury Prevention Plan are seldom performed in the Streets and Utilities Division. (Finding 11)

RATIONALE FOR RECOMMENDATIONS

The audit identified a number of areas where purchasing and payment procedures, as well as safety monitoring, could be improved. It also identified many internal control weaknesses likely to create conditions such that waste and abuse could go undetected. Implementation of the audit recommendations in this report will:

- Improve the efficiency and overall internal control structure over purchasing in Public Works and Citywide.
- Reduce the risk to the City that inappropriate or unnecessary purchases will be made and go undetected, or that City assets will be stolen.
- Increase the likelihood that competitive prices are paid for goods and services.
- Better ensure that the Equipment Maintenance Division bills other City departments for all the parts and outside services it purchases to repair City equipment.
- Possibly decrease the risk of employee accidents and injuries.

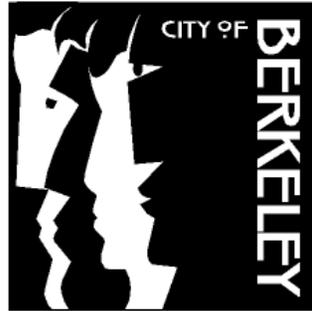
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Purchase Order Audit – Select Public Works Divisions At the Corporation Yard

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Presented to Council on March 15, 2005

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I. OBJECTIVES OF THE AUDIT

The objectives of this audit were to:

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

This audit was scheduled to be performed as part of the fiscal year 2005 audit plan as presented to City Council on June 22, 2004.

II. SCOPE AND METHODOLOGY

This performance audit looked at the current purchasing and payment procedures used by the following Public Works (PW) Divisions at the Corporation Yard:

- Equipment Maintenance (EM)
- Streets and Utilities (Streets)
- Public Works Administration* (PW Administration)

** Located at the Civic Center Building, not the Corporation Yard, but is involved with the Corporation Yard purchase order (PO) process.*

Audit work in this area was limited to PO activity, and did not examine purchase and payment activity associated with vouchers. Audit work in Streets was primarily limited to a walkthrough of purchasing and payment operations. Some audit work was also done in the Finance Department Purchasing Unit, primarily to identify citywide purchasing policies and procedures, and to review competitive pricing documentation for PW POs. Audit fieldwork began May 10, 2004 in PW Administration and concluded on December 17, 2004 in EM. Purchases made using POs during the first 11.5 months of fiscal year 2004 (July 1, 2003 through June 18, 2004) were examined. Safety records from calendar year 2003 and year-to-date 2004 were examined.

The information used to complete this audit was obtained primarily from:

- Walkthroughs of the purchasing and payment process with key personnel in the EM, Streets, and PW Administration Divisions.

- Review of written policies and procedures pertaining to the ordering and payment of goods and services purchased by PO.
- Discussion and written correspondence with staff in the PW, Finance, and Human Resources Departments, and in the City Attorney’s Office.
- Use of Audit Command Language software (ACL) to perform a digital analysis of fiscal year 2004 purchase payment records (as of June 18, 2004) and to select payment records and POs for review.
- Review of purchasing and payment documentation in EM, PW Administration, and Finance for goods and services purchased by EM.

The audit procedures for this audit were not designed specifically to detect fraud; however, they were designed to identify weaknesses in policies and procedures that could allow fraud or abuse to occur and go undetected during the normal course of business. Audit work was performed in accordance with Generally Accepted Government Auditing Standards and was limited to those areas specified in the scope and methodology section of this report.

III. EXECUTIVE SUMMARY

This audit, performed in the EM, Streets, and Administration Divisions of PW, looked at:

- Compliance with purchasing and payment procedures.
- Adequacy of the internal control structure for purchase and payment activity for POs.
- Effectiveness of efforts to reduce workers’ compensation claims by EM and Streets staff.

A summary of the major concerns follows:

1. The version of the City Purchasing Manual in use at the time of the audit, which is maintained by the Finance Department, was very outdated. Most of the policies, procedures, and purchase criteria in the manual were no longer applicable. (Finding 1)
2. There are a number of managers, supervisors, and other employees who can perform one or more incompatible purchasing and purchasing related duties in the EM and Streets Divisions. (Finding 2,10) When an employee can perform incompatible duties, such as purchase goods and then approve payment for those goods, errors and unauthorized activity can go undetected during the normal course of business. Additionally, a couple of employees have not been properly authorized to perform some of their purchasing duties. (Finding 7, 10) Finally, a senior supervisor gave his FUNDS\$ password to a subordinate supervisor, which gave the subordinate supervisor the ability to perform

incompatible duties, such as review and approve some of his own work, under his supervisor's ID. (Finding 2)

3. The parts inventory in EM is not secure and procedures are not in place to detect parts inventory used for purposes other than to repair City equipment (unauthorized purposes). Additionally, procedures are not in place that provide reasonable assurance that departments are billed for all parts and outside service purchases used to repair equipment. (Finding 4,5,6)
4. Sufficient competitive pricing, or price negotiation, is often not obtained before a PO is issued for EM. (Finding 3) It appears this condition may also exist at other PW divisions at the Corporation Yard.
5. The monthly documented safety inspections required by the City's Illness and Injury Prevention Plan (IIPP) are seldom performed in Streets. Inspections were generally performed in EM, but not in the office area as required. Also, responsibility for conducting the Streets inspections, and insuring corrective action was taken, was inappropriately assigned to someone outside the division. The City's IIPP requires that this responsibility be assigned to Streets' management. (Finding 9,11)

IV. BACKGROUND

The City of Berkeley Corporation Yard is located at 1326 Allston Way. The following PW divisions have staff at the Corporation Yard:

1. Equipment Maintenance (EM)
2. Streets and Utilities (Streets)
3. Facilities Maintenance
4. Electrical
5. Administration (Corporation Yard Customer and Budget Service Unit only)

Equipment Maintenance Division

The EM Division purchases, maintains, and repairs the City's trucks, cars, and other equipment, and is staffed with approximately 24 full time employees. About 15 of these employees work at the Corporation Yard and the others work at the City's Solid Waste Transfer Station, located at 1201 2nd Street. The Equipment Superintendent and Sr. Equipment Supervisor manage the EM Division from the Corporation Yard location. EM has one Warehouse Operations Specialist (parts person), who makes most of the division's purchases, and also keeps the parts rooms at the Corporation Yard and Solid Waste Transfer Station stocked. He works at the Corporation Yard.

Almost all of the purchasing activity for the Corporation Yard unit and Transfer Station unit takes place at the Corporation Yard.

For the first 11.5 months of fiscal year 2004, the EM Division of PW paid approximately 3,708

invoices totaling \$4,226,375. For the entire fiscal year ending 2004, parts and commercial service expenditures totaled \$832,784, of which \$527,041 was for the Corporation Yard unit. Most of the invoices associated with these expenditures were from purchases made via the division's approximately 123 blanket POs¹.

Blanket Purchase Orders

Each year the EM Superintendent and supervisors develop a list of vendors with whom they plan to establish blanket POs during the upcoming year. Generally, the same vendors are used every year. This list is provided to PW Administration, located at 2180 Milvia Street, where an Accounting Office Specialist III (AOS III) performs the first step in creating the blanket POs, the input of requisitions into the City's FUNDS\$ Purchase Inventory (PI) module. Once the requisitions are input, an analyst located at the Corporation Yard PW Customer and Budget Service Unit reviews and approves these requisitions online. Once approved, these requisitions are sent electronically to Finance Purchasing for "Buyer Approved Processing" in PI. A buyer then reviews the requisition on-line and approves the issuance of a PO. The Finance Department buyer may use the vendor provided by EM or may look for a better deal for the City. Each blanket PO identifies the employees authorized to make purchases from that vendor. It is always the same: the Equipment Superintendent, the Senior Equipment Supervisor, the two Mechanic Supervisors, a Lead Mechanic, and a Warehouse Operations Specialist (parts person). These blanket POs are used to purchase most of the parts needed to make equipment repairs.

One-time Purchase Orders

The procedure to issue a one-time PO is very similar to the procedure for issuing a blanket PO. However, for one-time POs, the Equipment Superintendent and the Sr. Equipment Supervisor may obtain quotes from vendors, then input the requisitions in PI themselves, rather than input being performed by an AOS III in PW Administration. Finance Purchasing may also obtain quotes or negotiate pricing. One-time POs are generally for outside services such as auto body repair work, or truck or car purchases. The truck and car purchases can be for hundreds of thousands of dollars.

Purchasing Criteria

The purchasing policies and procedures that all City departments must follow can be found in the City's Purchasing Manual, Citywide online contract procedures, Berkeley Municipal Code 7.18 (Purchases requiring City Council approval), and undocumented guidance provided by the Finance Department. Written procedures within each department address how the City's purchasing policies and procedures are implemented within the department.

¹ Blanket Purchase Order – a purchase order issued for a specified period of time for goods or services that are required on a recurring or continual basis during the time period.

Job Orders

The Mechanic Supervisors create a new job order in the FUND\$ Fleet Management Module each time a piece of equipment is brought in for service. The job order identifies the equipment being serviced, the work to be performed, and the mechanic assigned to perform the work. Only the two Mechanic Supervisors, the Sr. Equipment Supervisor, and the Equipment Superintendent are authorized to create job orders. The job orders are printed by the supervisor and given to the Mechanics or Service Technicians assigned to perform the repair. The Mechanics and parts person record on the job order the parts (and the cost of the parts) and the labor hours it took to complete the repair.

Next, these job orders are given to the Supervising Mechanic for review. After this review, the job orders are given to an Office Specialist III in the Corporation Yard Customer and Budget Services Unit. This individual enters the labor and parts information into the Fleet Management module, and later closes the job orders after the input has been reviewed and approved by the Sr. Equipment Supervisor.

A Mechanic Supervisor inputs the job orders for outsourced services and repairs, generally bodywork, into the Fleet Management System. The Sr. Equipment Supervisor reviews and finalizes this input at the end of each month. Also at the end of each month, the job order information input into the Fleet Management System is used to bill each of the City departments for the cost of the services and repairs received.

The Equipment Superintendent is the module leader for the Fleet Management module. His ability to give and take away any module authorization from any employee, including himself, was taken away during the audit.

Receipt of Goods and Invoice Payment

The EM Superintendent, supervisors, and the parts person can sign for the receipt of goods and services. On each invoice is written the job order number and I.D. number for the equipment the part was used to service. Alternatively, it is noted on the invoice that the part was placed in inventory. The Sr. Equipment Supervisor generally reviews and approves for payment the invoices for both of the EM units, although the Equipment Superintendent, one of the two Supervising Mechanics, and two analysts in PW Administration are also authorized. Approval is documented by initialing the invoice. The Sr. Equipment Supervisor also stamps the invoice “Received + date”. Once PW Administration staff receive the approved invoice, they receive it on-line in PI. The invoice is then forwarded to Finance Accounts Payable for payment.

Streets and Utilities Division

The Streets Division also makes most of its purchases using blanket POs and most of the same vendors are also used year-after-year. The procedure for creating the blanket POs in Streets is very similar to the procedure used by EM.

Release Forms

A three part pre-numbered “release form” (two carbon copies) is used to purchase materials, tools, and equipment using one of the divisions’ 43 blanket POs. These forms are generally completed and approved by either one of the two Sr. PW Supervisors, but the PW Maintenance Superintendent (division manager) is also authorized. The original and one copy of the release form are taken to the store by other City staff, or faxed to the vendor by the supervisor that requested the purchase. Before the invoice from the purchase is approved for payment by one of the Sr. PW Supervisors or the PW Maintenance Superintendent, a copy of the approved release form is compared with the invoice or packing slip to make sure no unauthorized purchases were made. Approval is documented by initialing the invoice, packing slip, or release form. The invoice and other required purchase documentation are then sent to PW Administration, where if everything is in order, staff “receive on-line” in the PI module and send it to Finance Accounts Payable for payment.

One-time Purchase Orders

The Sr. PW Supervisors and the PW Maintenance Superintendent are authorized to input requisitions into the PI Module for the Streets Division. As in EM, Streets requisitions are reviewed and approved online in the PI Module by a Sr. Management Analyst assigned to the Corporation Yard Customer and Budget Services Unit.

The Sr. PW Supervisors and the PW Maintenance Superintendent are also authorized to approve the payment of invoices. Once PW Administration staff receive approved invoices, they are “received on-line” in the PI Module, then forwarded to Finance Purchasing for payment.

**V. FINDINGS AND RECOMMENDATIONS
FINANCE DEPARTMENT**

Finding 1 The City’s Purchasing Manual Is Very Outdated.

The purchasing requirements and procedures in the City’s Purchasing Manual (Manual) are very outdated, often requiring City employees to determine what the official purchasing policies and procedures really are through other means. The purpose of the Manual is to provide City staff with the City’s policies and procedures, organizational relationships, and standards of conduct for purchasing goods and services. It appears the Manual was issued by the Finance Department in the early 1980s, when the City had another far less automated accounting system. Concerns with the current Manual include the following:

- A. The dollar thresholds for competitive pricing requirements for the purchase of goods are outdated.
- B. Contract requirements for service purchases differ from recently adopted on-line citywide contract procedures for service purchases.
- C. Although the Manual states that only Finance Purchasing staff are to contact vendors for quotations, PW staff routinely contact vendors because there has been insufficient staffing in Finance Purchasing to perform this function for all the purchases being made for quite some time. During the audit, additional staff were being hired in Finance Purchasing.

Finance has been drafting a new purchasing manual for quite some time, but it was never approved and issued. The recently hired General Services Manager stated she plans to complete the work on this Manual, and oversee that it is approved and distributed to the departments, when additional staff are hired in Purchasing and she can stop performing buyer duties.

Additionally, a definition for a “service purchase” is not available and it is sometimes unclear when purchasing requirements for goods or services should be followed. It appears that in some instances purchases are being treated as a goods purchase when they are a services purchase. Service purchases require contracts and a PO, rather than simply a PO. As a result, a contract may not always be obtained when it is in the City’s best interest to do so. As an example, PW considers outsourced auto body repair work to be a purchase of a good and not a service. Therefore, in this situation, they are only using a PO and a vendor contract for the purchase, but not a City contract. Regarding the auto body repair example above, the City Attorney’s Office has indicated that auto body repair work appears to be predominantly a service, so purchase requirements for a service should be followed. If, however, auto bodywork is predominantly for the purchase of parts, then the procedures for the purchase of goods should be followed. The Director of Finance has stated that Finance is working to identify low risk, low dollar volume services that might benefit from a less arduous contract process.

Recommendation for Finance

- 1.1 Fully update, finalize, and distribute the Purchasing Manual to all departments within six months of the date this audit report is presented to City Council. Establish and implement policies and procedures in Finance for the updating of the Purchasing Manual at least annually.

Recommendation for Finance and the City Attorney's Office

- 1.2 Establish the definition for a service purchase and identify the purchasing procedures to be followed for service purchases. This definition and these procedures should be included in the updated Purchasing Manual.

Recommendation for the City Manager

- 1.3 Update the City's on-line contract manual to incorporate the definition for a service purchase as established in recommendation 1.2. Also update the on-line contract manual to include procedural changes associated with the new service purchase definition.

City Manager's Response

Finance, the City Attorney, and the City Manager agree with finding 1. Responses to audit recommendations follow.

- 1.1 *Finance agrees with recommendation 1.1 and will fully implement it by June 30, 2005. Recommendation has been partially implemented as of January 31, 2005. The draft Purchasing Manual for initial use by City staff was posted on iCobWeb (the City's intranet site) in January 2005. The draft Manual will be revised as feedback is received by the General Services Manager from department end users. After feedback is reviewed and incorporated into the draft, and the City Attorney's Office has completed review and approval for publishing, the final Purchasing Manual will be distributed to staff on iCobWeb by June 30, 2005. Policies and procedures in the Purchasing Manual will be reviewed annually, and updated at that time or on an as-needed basis.*
- 1.2 *Finance and the City Attorney agree with recommendation 1.2 and will implement it by June 30, 2005. A definition for a "service purchase" agreeable to General Services and the City Attorney will be included in the final version of the Purchasing Manual. However, it is not possible to develop a definition that encompasses all service purchases, or purchasing procedures for all types of service purchases. For example, a service cited for bodywork on a vehicle could be a service or goods, depending on what is done.*
- 1.3 *The City Manager agrees with recommendation 1.3 and will implement it by September*

30, 2005.

**VI. FINDINGS AND RECOMMENDATIONS
EQUIPMENT MAINTENANCE DIVISION**

Finding 2 The Equipment Superintendent, Sr. Equipment Supervisor and a Mechanic Supervisor Can Perform Incompatible Purchasing and Purchasing Related Duties

The Equipment Superintendent, Sr. Equipment Supervisor, and the Mechanic Supervisor assigned to the Corporation Yard have the authorization to perform a number of incompatible duties in the EM Division pertaining to purchasing and payments for parts and services, and the subsequent accounting for these parts and services in the City’s Fleet Management Module. This significantly increases the risk to the City that errors and inappropriate activity will go undetected during the normal course of business. This risk is further increased by the concerns discussed in Finding 4 (no reconciliation to identify unaccounted for parts purchases) and Finding 5 (unsecured parts room). It appears that the reason these employees have the ability to perform so many incompatible duties is so they can fill in for other employees, and help ensure work is accomplished timely.

Specific concerns are:

Blanket POs

The Equipment Superintendent, Sr. Equipment Supervisor, and a Mechanic Supervisor select the blanket PO vendors (approximately 123) each year, and once the blanket POs are established, they have the authorization to buy goods or services from these vendors, receive these goods, and approve these purchases for payment. Additionally, since the Sr. Equipment Supervisor and Mechanic Supervisor fill in for the parts person in his absence, a position that purchases and receives most of the parts for the division, their purchasing activity would not be readily observed as being inappropriate. Having the ability to approve your own purchases significantly increases the risk that unauthorized purchases will go undetected.

Although “General Purchasing Procedures” in PW Administration state that a person who places an order cannot be the same person receiving it or approving it, this internal control is not adequate by itself because it is only designed to detect inappropriate activity after it occurs, but does not prevent it from occurring.

Fleet Management System

The Equipment Superintendent and the Sr. Equipment Supervisor are authorized to perform almost all functions in the Fleet Management Module. Also, the Mechanic Supervisor has Fleet authorization to perform incompatible tasks. The following examples illustrate the types of incompatible duties they can perform in Fleet.

Example 1

An Office Specialist III in another unit is supposed to be the only one authorized to enter the labor and parts information from the job orders into the Fleet Management module and close the job orders. However, the Equipment Superintendent, Sr. Equipment Supervisor, and a Mechanic Supervisor have the authorization in the Fleet Module to perform these functions. All three can also create job orders and post job order input.

Example 2

The Mechanic Supervisor at the Corporation Yard is supposed to be able to input commercial service invoices (like bodywork from an outside body shop) from job orders into the Fleet module. However, he is not supposed to be able to post this input. This input is supposed to be reviewed and posted by the Sr. Equipment Supervisor. However, the Mechanic Supervisor is authorized in the Fleet module to post his own commercial service invoice input. In fact, all three can enter, edit, and post commercial transactions.

The Equipment Superintendent is the module leader for the Fleet Management Module. Early in the audit, during May 2004, he had the ability to do everything in the module, including granting employees, including himself, the authorization to perform any function. The auditors brought this condition to management's attention on July 2 and sometime later that month this authorization was removed, according to the Acting Supervising System Analyst in the Information Technology Department. The system analyst stated that this authorization was taken away from all module leaders in July 2004 due to a bug in this part of the system, and that this change later became policy. However, the Equipment Superintendent still has the authorization in the Fleet Module to do everything except grant employees authorization to module functions and purge information.

Sharing FUNDS\$ Identification

The Sr. Equipment Supervisor has given the Mechanic Supervisor at the Corporation Yard his FUNDS\$ password so he can fill in for him as needed. This allows the Mechanic Supervisor to perform incompatible duties under his supervisor's ID. For example, the Mechanic Supervisor is already authorized to input invoices for commercial services into the Fleet Management System, and under the Sr. Equipment Supervisor's ID, would also be able to post his own input under his supervisor's ID so it would appear as though it had been posted by his supervisor. The Mechanic Supervisor would also be able to submit requisitions for goods and services under the Sr. Equipment Supervisor's ID, authorization he has not been given as a Mechanic Supervisor.

Concerns With Invoice Approval

A key internal control to prevent inappropriate purchases is the review and approval of purchase requisitions by a PW analyst located at the Corporation Yard, but outside of the EM division. However, it does not appear that this analyst can adequately review EM requisitions because she does not appear to work closely enough with EM operations to be able to identify inappropriate purchases. For example, it appears she would not be familiar enough with EM operations to know if too many tires, or too many tires of a particular size, were being requisitioned. Early in the audit, this analyst reviewed and approved the requisitions for all the PW divisions at the Corporation Yard. During the audit, this analyst retired, and this condition became more of a concern. Her current replacement, another analyst, works at the PW Administration Division at City Hall, so she is physically farther from EM. She stated she approves the requisitions after confirming money is in the budget and the proper element/object code portion of an expenditure code is being used. It does not appear requisitions are being adequately reviewed before being approved.

Relationship with Former Purchasing Manager

The Finance Director did not put internal controls in place to mitigate the existence of a domestic relationship between the former Acting Purchasing Manager in Finance and the Equipment Superintendent in EM. The inherent risk was demonstrated when the Equipment Superintendent submitted a \$600,000 requisition for the purchase of three refuse trucks using an old Council resolution that had already been used to purchase the approved number of trucks, and the former Purchasing Manager made the unauthorized purchase. It was not determined whether the Purchasing Manager issued the PO with awareness that the purchase had not been approved by Council, or whether the approval was made in error. Although the purchase was not in compliance with City policy and procedures, we found that all refuse trucks purchased are in use at the City's Transfer Station so there is no indication of improper use of assets. However, in a situation where there is a conflict of interest, there is an increased risk to the City that irregularities will occur and go undetected.

The Finance Director attributes the above occurrence to the total lack of staffing in the procurement area during 2001 through 2003, which she states had a severe detrimental effect on the quality of operations, and obviously on the consistent maintenance of internal controls. Specifically, she stated that, during this period, the Acting Purchasing Manager was not able to, and did not, look up each and every resolution for every transaction she completed. The Finance Director stated that, during the late 1980's, Purchasing was a separate department with eight employees. However, during the time of the Acting Purchasing Manager, only four employees were authorized and attendance was an issue to such an extent that one employee was attempting to do the work of the four remaining authorized FTEs. The Finance Director further stated that the current practice is for Purchasing staff to verify dollar amounts and resolutions for all procurements.

There are no written purchasing policies and procedures in EM that identify the purchasing procedures to be performed in the division, how they are to be performed, and who is to perform

them.

Recommendation for Public Works and Information Technology

- 2.1 As Fleet Management Module leader, the Equipment Superintendent should not have the ability to give himself the authorization to perform any functions in the module. Although this change was made during the audit, this restriction should be documented and enforced. Additionally, no EM Division employees should have authorization in the Fleet Management system to review and approve his or her own input.

Recommendation for Finance

- 2.2 Update the Purchasing Manual to include verbiage stating that it is against City policy for an employee to approve a financial transaction for a near relative. This update should refer to AR 2.12 for the definition of a near relative, which includes a domestic partner.

Recommendations for Public Works

- 2.3 Take away the Equipment Superintendent's and Sr. Equipment Supervisor's authorization on the blanket POs to make purchases, since they are authorized to approve invoices for payment. No employee should have dual authorization to make purchases by blanket PO and also authorize these purchases for payment.
- 2.4 Create and issue written policies and procedures for the EM division that cover the step-by-step purchasing process in EM (including Fleet Management activity) from beginning to end. These procedures should be detailed enough to allow a new but qualified employee to read them and know what authorization they have, what tasks they are to perform, and how to perform them.
- 2.5 Requisitions for PW Divisions located at the Corporation Yard should be reviewed and approved by an analyst, supervisor, or manager familiar enough with division operations to effectively review requisitions before approving them.
- 2.6 Under no circumstances should the Sr. Equipment Supervisor or any other employee give another employee his or her FUND\$ password. This directive should be included in EM division written policies and procedures.
- 2.7 When employees temporarily fill in for other employees, the employees who backfill should have their usual authorization removed if it is not compatible with their temporary duties. Authorization should be taken away for a long enough period that staff would be unable to return to their primary job classification and review and approve their own work using authorization obtained from the temporary assignment. This policy should be incorporated into the written policies and procedures in EM.

City Manager's Response

Finance and PW agree with finding 2. Responses to recommendations follow.

- 2.1 PW and Information Technology agree to implement recommendation 2.1, with the possible exception of segregating the input and posting (finalizing input) functions using the Fleet Management Module, because this can't currently be done. If cost effective to do so, Information Technology or HTE (accounting software vendor) will make the needed programming changes to allow this. Otherwise, a supervisor who is not authorized to input and post will review and approve posting activity on a sample basis, and this review and approval will be documented. This recommendation, excluding any required programming changes, will be implemented by July 1, 2005.*
- 2.2 Finance agrees with recommendation 2.2 and will implement it by June 30, 2005.*
- 2.3 PW agrees with recommendation 2.3 and will implement it by July 1, 2005.*
- 2.4 PW agrees with recommendation 2.4 and will implement it by July 1, 2005.*
- 2.5 PW agrees with recommendation 2.5 and will implement it by July 1, 2005.*
- 2.6 PW agrees with recommendation 2.6 and will implement it by July 1, 2005. This directive will be included in the PW Purchasing Manual and EM Purchasing Manual. The EM Purchasing Manual may be incorporated into the PW Purchasing Manual.*
- 2.7 PW agrees to implement alternative corrective action in place of recommendation 2.7 to clear the finding by July 1, 2005. EM Division anticipates having a separate user identification created for use by Mechanics acting as the Mechanic Supervisor when the Supervisor is on leave. For security, the Supervisor would give the current password to the acting supervisor, and would change the password when he or she returns to work.*

Finding 3 Sufficient Competitive Pricing Is Often Not Being Obtained Before a Purchase Order Is Issued

There is a general lack of competitive pricing being obtained before POs are issued for the EM Division. As a result, the City is more likely to pay more for goods, and there is an increased risk that inappropriate purchasing activity with a particular vendor will occur and go undetected.

Blanket Purchase Orders

Most of the blanket POs for the EM Division are issued to the same vendors year-after-year

(approximately 123 during fiscal year 2004). Competitive pricing associated with the blanket POs greater than \$5,000 was generally not available or inadequate. For the four blanket POs reviewed that individually totaled more than \$5,000, there was no competitive pricing for two and inadequate competitive pricing for two. For example, PO 46669 is a \$15,200 blanket PO for automotive parts awarded without any evidence of price competition or price negotiation. It is true that approximately 2/3 of the 123 EM blanket POs were for \$5,000 or less, and therefore competitive pricing was not required by Finance as part of the vendor selection process. However, it does not appear to be in the City's best interest to use the same large group of vendors year-after-year without any procedure in place to help insure the prices the City is paying to these vendors are competitive. The EM and Street divisions at the Corporation Yard largely rely on Finance Purchasing to take the steps needed to insure competitive pricing. However, it appears Finance Purchasing has not had the staffing to perform required tasks. Purchasing representatives agree this condition exists, and that it is a concern. During the audit, they began identifying the City's larger dollar blanket POs, with plans to obtain competitive pricing and /or renegotiate some of the larger dollar POs in the near future.

Competitive Pricing Piggybacking

“Piggybacking”, the use of competitive pricing data from other jurisdictions, is not always adequately documented or done properly by staff in PW or Finance. Of the nine POs reviewed, two involved piggybacking. In one instance, blanket PO 46555 for \$18,900 was based on a citywide three-year contract with a laundry service for \$375,000. The General Manager working in Finance Purchasing stated the City had piggybacked, using a City of Sunnyvale competitive bid. However, documentation could not be provided to support this statement. In the second instance, one-time PO 46131 was issued to a truck dealership for \$512,698 for the purchase of three refuse trucks. Competitive pricing information was provided by the dealership, rather than by the jurisdiction that obtained the competitive pricing. In this situation, there is the possibility the City could unknowingly receive price competition documentation that was not legitimate or complete. Additionally, the price competition documentation was for only one truck, rather than for three, as Berkeley was purchasing. The higher quantity could have resulted in a price discount. The City does not have written policies and procedures pertaining to the use of competitive pricing data from other jurisdictions.

Recommendations for Finance and Public Works

- 3.1 Update the Purchasing Manual to incorporate internal controls that will provide reasonable assurance that when blanket POs exceed a certain amount (current amount established by Finance is \$5,000), vendor prices are competitive (negotiated discounts or competitive pricing). Additionally, annually require a competitive price analysis for at least 10% of the planned blanket POs in each PW division that are under \$5,000, as long as the division has at least 20 blanket POs. This analysis should be used to negotiate fair pricing with these vendors, and this activity should be documented. The documentation supporting competitive pricing efforts should be retained for two years after the POs are

no longer being used.

- 3.2 Update the Purchasing Manual to clearly define what kind of competitive pricing data from other jurisdictions is an acceptable alternative to obtaining competitive pricing directly from vendors. To avoid vendor misrepresentation of the facts, only competitive pricing data provided to the City by the purchasing staff of other jurisdictions should be considered acceptable. Additionally, for piggybacking to be acceptable, quotes obtained should be for comparable quantities and like quality. Lastly, require competitive pricing data be maintained for a minimum of two years after a PO is closed as evidence pricing competition was obtained.

City Manager's Response

PW and Finance agree with finding 3. Responses to recommendations follow.

- 3.1 *PW and Finance agree with recommendation 3.1. Once the position of Senior Buyer, which will be dedicated to PW procurement, is approved and filled in fiscal year 2006, General Services Procurement will be able to set up a system to obtain competitive pricing for at least 10% of the planned PW blanket POs under \$5,000.*
- 3.2 *PW and Finance agree with recommendation 3.2. Finance stated implementation of the recommendation, including requirements for accepting "piggybacking" quotes and retaining data, will be included in the Purchasing Manual available to staff by June 30, 2005.*

Finding 4 No Reconciliation Is Performed to Identify Parts Purchases That Are Neither on Hand in Inventory Nor Recorded In the Fleet Management Module As Used for a Repair

Total EM parts expenditures and outside service expenditures accounted for in the City's general ledger (FUNDS) are not being periodically reconciled to the total cost of parts and outside services charged to job orders in the City's Fleet Management Module, and the increase or decrease in the cost of parts in inventory. This reconciliation would identify the total cost of parts and outside services that were unaccounted for (not recorded in the Fleet Management Module or available in parts inventory). As a result, parts and outside service expenditures incurred by EM for non-inventory items, that are not charged back to the City departments that received them, will probably go undetected. Additionally, lost or missing parts will also probably go undetected. Since the physical parts inventory is not secure (Finding 5), the cost of missing parts could be significant.

Of the nine invoices reviewed during the audit, one for approximately \$1,800 had not been input into the Fleet Management Module and had not been billed to the Police Department.

Recommendation for Public Works

4. At least quarterly, parts and outside service expenditures recorded in the FUNDS\$ general ledger should be reconciled to the cost of these parts and services charged to jobs in the Fleet Management Module and the change in the value of the in-house parts inventory. An employee who does not have significant involvement with the activity being reconciled should perform the reconciliation, and this reconciliation should be documented in writing and retained. The cause of significant differences should be researched, identified, and corrected. This procedure should be part of the divisions' written policies and procedures.

City Manager's Response

PW agrees with finding 4 and the audit recommendation. PW will develop a plan with the Finance Department for a new inventory system by July 1, 2007. Quarterly, the analyst in the EM Division will prepare the audit recommended reconciliation beginning July 1, 2007.

Finding 5 Parts Inventory Is Not Adequately Secured and a Record of Parts Inventory Is Not Maintained

The Equipment Maintenance Division maintains a physical inventory of parts and tires that is not adequately secured. No inventory record is kept of these in-stock items. As a result, parts and tires not used for authorized purposes could go undetected. There are no written policies and procedures pertaining to the safeguarding of parts inventory.

The Sr. Equipment Supervisor explained that parts inventory was not adequately secured because there was only one parts person. He stated that in order to secure the parts inventory, two additional parts staff would be needed so there could be one parts person at the Corporation Yard during the day, one at the Transfer Station during the day, and one at the Transfer Station during the night. He stated that it had been decided that this would be too expensive. Currently, there is only one parts person located at the Corporation Yard. He works during the day and provides all the parts for everyone. Because of the need to pick up and deliver parts, he is not always in the Corporation Yard parts room. During these times, staff routinely enter the inventory rooms and get the parts that they need. Additionally, tires and some other parts are stored on a mezzanine. Access to this area is not restricted. The Sr. Equipment Supervisor stated that other options considered to secure the parts inventory areas included having full time on-site personnel from a car parts business replace the City parts person (City would be required to buy their parts from this vendor when available), having only one inventory location instead of two, or dividing the parts person's presence between the two inventory locations. Management believed all these alternatives to be unworkable.

A former Communications Service Technician from Facilities Maintenance is currently the acting parts person and is not knowledgeable about maintaining a parts inventory.

Recommendations for Public Works

- 5.1 At least annually, compare the cost of unaccounted for parts and outside repair services (See audit recommendation 4) with the estimated cost to increase the security over the parts inventory. If cost effective to do so, increase the level of security over inventory. This analysis, and resulting decisions, should be documented and retained.
- 5.2 Develop and implement written policies and procedures to improve the security over parts and tire inventory with current staffing. For example, develop procedures and guidelines to help maintain a minimum inventory of parts. This can be accomplished by not keeping parts in inventory that can be quickly ordered and received. Also, consider further restricting accessibility to expensive items such as tires. For example, perhaps only the Mechanic Supervisor and Sr. Equipment Supervisor should have a key to access the tire inventory area, and they should do so only with the mechanic requiring the tires for a job order.

City Manager's Response

PW agrees with finding 5. Responses to audit recommendations follow.

- 5.1 *PW agrees with recommendation 5.1 and will implement it by July 1, 2007.*
- 5.2 *PW agrees with recommendation 5.2 and will implement it by July 1, 2005. Policies and procedures will be written down to improve the security over parts and tire inventory. Tires are locked in a cage at the Transfer Station. A system to secure the tires at the Corporation Yard will be implemented by July 1, 2005.*

Finding 6 Procedures Do Not Provide Reasonable Assurance That Repair History in the Fleet Management Module is Accurate and Complete

Policies and procedures do not provide reasonable assurance that parts expenditure information in Fleet Management is accurate and complete. This condition exists for the following reasons:

1. Information on job orders is not authenticated by those who complete it.
2. Lack of segregation of duties.
3. Lack of documented review.

Information on job orders is not authenticated by those who complete it

The Mechanics, Service Technicians, and Warehouse Operations Specialist do not initial or sign their job orders to indicate parts and labor information is accurate, and to help prevent

unauthorized changes.

Lack of segregation of duties

Finding 2 identified the concerns pertaining to the incompatible duties that the Equipment Superintendent, Sr. Equipment Supervisor, and a Mechanic Supervisor can perform in the Fleet Management Module.

Additionally, five mechanics always have the authorization to create job orders, even though they are not supposed to perform this task as Mechanics, at least in part because it can be used to monitor their performance. This authorization was given to these mechanics so they could fill in for the Mechanic Supervisor in his absence. However, having this authorization all the time allows these five mechanics to create job orders when they are not supposed to.

Lack of documented review

Management states several procedures are being performed to insure job order information is accurate and complete; however, this activity is not documented. There are no written policies and procedures addressing the procedures described, and job order records are not signed or initialed to document which records received the review or reviews described. The following are important internal controls that we could not verify were in place because of this lack of documentation, though EM management states they are performed:

- Sr. Equipment Supervisor:
 - Traces about 10% of the larger dollar invoices to the Fleet Management System (job orders) to insure they were accurately input. It was also noted that none of the invoices considered “not large” are traced, which is a concern.
 - Randomly inspects equipment to make sure the work on the job order was actually done.
 - Randomly checks approximately 25% of the larger dollar job orders to make sure parts and labor were properly entered, and the job was closed, in the Fleet Management system.
- Mechanic Supervisors:
 - Review the information recorded on the job orders for accuracy.
 - Inspect some of the equipment to make sure repair work on job orders was actually done.

Recommendation for Public Works

6. Supervisory review of job orders and Fleet Management input should be sufficient to provide reasonable assurance that this information is materially accurate. Completion of

review and approval steps performed should be documented, for example, by the reviewer initialing and dating the information that was reviewed. We further recommend that the mechanics, parts person, and supervisors initial the dollar total for parts and the hours total for labor on each job order. This will serve to document that this information is accurate and prevent it from being inappropriately altered. No employees should have the ability to review and approve their own work or change the work of others. Specifically how these tasks are to be completed, and who is to complete them, should be addressed in written policies and procedures in the EM division. Mechanics should not be given the authorization in the Fleet Management System that is given to the Mechanic Supervisors until they are actually assigned to temporarily fill the position of Mechanic Supervisor. The authorization should be revoked when the temporary assignment is concluded.

City Manager's Response

PW agrees with finding 6, and the recommendation, and will implement the recommendation by July 1, 2005.

Finding 7 The List of Employees Identified on the Blanket Purchase Orders As Authorized to Make Purchases is Outdated

A former Communication Service Technician filling in for the vacant Warehouse Operation Specialist position (parts person) is purchasing most of the parts for the Equipment Maintenance Division even though he is not listed on the approximately 123 blanket POs as one of the City employees authorized to make purchases. Additionally, the former parts person had not been removed as an authorized purchaser.

Division management stated that some of the vendors had called to make sure the acting parts person was approved to make purchases before selling him goods. However, this practice may encourage businesses to become complacent regarding their responsibility to only sell to people authorized on a City of Berkeley PO. It may also reduce their liability if sales are made to an unauthorized individual. Lastly, if a former employee or an unauthorized employee, does not have his or her purchase authorization timely removed from blanket POs, there is risk of use of this authorization to make unauthorized purchases or purchases for personal use. Businesses may require the City to pay for these purchases, given that the purchasers were authorized on the PO, making the City responsible for the improper sale.

Recommendation for Public Works and Finance

7. The list of employees authorized to make purchases on the EM blanket POs should always be current. Written procedures in PW should identify this as a policy and establish a means

to implement and enforce this policy. The Purchasing Manual should state that all departments should establish a procedure to implement and enforce this policy.

City Manager's Response

PW and Finance agree with finding 7 and the recommendation. EM will send an updated list of blanket POs and employees authorized to make purchases to the Finance Department when employees authorized to make purchases changes. PW will update their written policies and procedures by July 1, 2005. Finance will have the updated purchase manual online by June 30, 2005.

Finding 8 Vendors are Sending Invoices to Multiple City Locations

Instructions on City POs ask vendors to send their invoices to P.O. Box 700, but the Equipment Superintendent instructs vendors to send their invoices to EM if they have any problems so that they can be timely reviewed and approved by the Sr. Equipment Supervisor. EM representatives stated that the vendors are sending invoices to three different locations, the Corporation Yard at 1326 Allston Way, P.O. Box 700 (Finance Accounts Payable) and 2180 Milvia (City Hall). EM management acknowledged that this practice increased the risk that vendors will send invoices to multiple locations and be paid twice in error. Therefore, they have the parts person review all invoices received at EM before they are approved for payment to catch these duplicate invoices.

Recommendation for Public Works and Finance

8. EM should request all vendors to send their invoices only to P.O. Box 700.

City Manager's Response

PW and Finance agree with finding 8 and the recommendation. PW will have vendors send invoices to P.O. Box 700, unless they receive the invoices immediately upon receipt of vehicles and equipment. They will immediately send these invoices to Finance Accounts Payable to ensure payment is made and discounts are received.

Finding 9 Documented Safety Inspections Are Performed Less Frequently Than Required

Documented monthly safety inspections of the Corporation Yard EM Division service area were

not performed for January – March 2004. The City’s Injury and Illness Prevention Plan (IIPP) requires monthly safety inspections for non-office areas. The City’s IIPP also requires that safety inspections of office areas be performed at least semi-annually. However, no documented inspections of the Corporation Yard EM office area were performed. The City’s IIPP is a requirement of Title 8 of the California Code of Regulations. When safety inspections are not performed as frequently as required, or are not performed, there is an increased risk that an injury may occur that could have been prevented by a safety inspection and the resulting corrective action.

It should be noted, however, that, during the audit, the City’s Workers’ Compensation Analyst in the Human Resources Department stated that EM management was doing a very effective job communicating with her department. She stated that she believed that EM management’s efforts helped to significantly minimize the number of workers compensation claims in EM.

Recommendation for Public Works

9. Perform documented safety inspections of the office work areas at least semi annually, and non-office operations at least monthly, in accordance with the City of Berkeley’s Injury and Illness Prevention Plan. Retain the safety inspection documentation.

City Manager’s Response

PW agrees with finding 9 and has already implemented the recommendation.

<p>VII. FINDINGS AND RECOMMENDATIONS - STREETS AND UTILITIES DIVISION</p>

Finding 10 The Manager and Two Supervisors Can Perform Incompatible Purchasing Duties

The PW Maintenance Superintendent (division manager) and two Senior PW Supervisors can perform incompatible purchasing duties for blanket PO purchases. As a result, there is an increased risk that errors and unauthorized purchases could go undetected.

The PW Maintenance Superintendent and two Senior PW Supervisors are authorized to complete and approve pre-numbered Release Forms (purchase requests), and later approve invoice payment. As a result, there is an increased risk that these employees may make inappropriate purchases and approve them, and that this activity will go undetected.

Also, identifying whether a supervisor has authorized his or her own purchase on a Release Form

may not be evident by inspecting the form. This is because, in the “Requested by” and “Approved By” fields, the names are at least sometimes being printed rather than signed, by the same individual. This condition was observed on some of the selected Release Forms completed by Streets personnel and the two reviewed Release Forms completed by Electrical Division personnel. Signatures would help to authenticate the identities of requestor and approver and aid both the vendors (at the time of the sale) and PW Administration staff (before “receiving on-line” in the PI module) identify suspicious Release Forms. It is also a concern that the Release Forms are not provided to PW Administration when a City employee does not pick up purchases because then PW Administration staff do not have the opportunity to review the Release Form for the concerns mentioned above. The above concerns also appear to exist in the Electrical Division. It was also observed that pre-numbered Release Forms were not being inventoried or reviewed to detect missing forms. However, they were being kept out of sight.

Lastly, one of the two Senior PW Supervisors that the division manager stated was authorized to approve payments for invoices resulting from Release Form purchases had not been properly authorized to have this authority. The required signature card granting this authorization was not on file in Finance Accounts Payable. The signature of the PW Director and City Manager are required to grant an employee this authorization.

There are no written policies and procedures that notify staff in Streets how purchasing and payment tasks should be performed and who is authorized to perform each task.

Recommendation for Public Works

10.1 Develop and implement written policies and procedures in the Streets Division for purchasing and payment processing within the division. Identify who can perform each task. Procedures should be detailed enough to permit a new but qualified employee who followed them to perform assigned tasks as management wants them performed. The written procedures should require both the employees requesting the purchase of goods or services by blanket PO, and the supervisors authorizing these purchases, to sign the Release Form. PW Administration staff should not “receive on-line” in the PI Module to authorize payment for these purchases until they receive the Release Form, and until they make sure that:

- The form was signed by the employee requesting the purchase and the supervisor approving the purchase, and
- The supervisors are not approving a purchase they made themselves.

We further recommend that this recommendation be implemented in the Electrical Division.

10.2 If unauthorized use of a Release Form is discovered, these forms should be inventoried and secured, and all pre-numbered Release Forms accounted for. Matching a copy of the Release Form with an invoice would make this discovery.

Recommendation for Public Works and Finance

- 10.3 A PW employee should not be permitted to approve an invoice for payment until the department director and the City Manager have signed a signature card granting this authority, and the card is on file in Finance Accounts Payable.

City Manager's Response

PW agrees with finding 10 and recommendations 10.1 and 10.2 and will implement recommendation 10.1 by July 1, 2005.

Finance and PW also agree with recommendation 10.3. Streets Division has already drafted and implemented a new internal policy clearly delineating purchasing duties within its division, and signature cards are updated with the names of employees who can approve invoice payments. Finance Accounts Payable staff do compare the employee signatures on invoices that approve payment with those signatures it maintains on file as having authority to do so.

Finding 11 Required Documented Safety Inspections Are Seldom Performed

Documented safety inspections are seldom performed at the Streets Division. The City's Injury and Illness Prevention Program (IIPP) states that the purpose of these inspections is to identify and correct unsafe work conditions or work practices. The IIPP requires that non-office work operations be inspected at least monthly, and office operations be inspected at least semi-annually.

For the twelve-month period ending June 2004, documented safety inspections were only available for the months of May and June 2004. These two inspections documented that a Streets Division employee had inspected the Corporation Yard, but the inspection reports did not make clear which areas had been inspected. In addition to Streets, other PW divisions and another department also occupy the Corporation Yard. The documented inspections did not use the inspection checklist recommended in the City's IIPP.

Lastly, although the PW Operations Assistant in the PW Administration Division has been assigned responsibility for making sure safety inspections are performed and safety concerns are corrected in the Streets Division, the City's IIPP assigns this responsibility to the managers and supervisors in the Streets division and also the department director. The Operations Assistant stated that he was currently training a Streets division employee to perform the safety inspections. He also stated that he sometimes conducted safety walkthroughs in the Streets Division that were not documented. In this situation, he simply mentioned his concerns to whoever was there.

Recommendations for Public Works

11. Perform and document periodic safety inspections of the Streets Division's non-office and office work operations in accordance with the City's IIPP. Assign the responsibility for making sure safety inspections are performed, and that safety concerns identified during these inspections are corrected, to the managers and supervisors in the Streets Division and the PW director. Inspections should be documented using the checklist in the City's IIPP or an alternative approved by the City's Occupational Health and Safety Coordinator.

City Manager's Response

PW agrees with finding 11 and has already implemented the recommendation in accordance with the City's IIPP.

VIII. CONCLUSION

The audit identified a number of areas where purchasing and payment procedures, as well as safety monitoring, could be improved. A significant reoccurring concern was employees in PW with incompatible purchasing and purchasing related duties.

As stated in the scope section of this audit report, this audit was not designed specifically to detect fraud, and none was found. However, the audit did identify many internal control weaknesses such that waste and abuse could easily go undetected. The prompt implementation of the audit recommendations in this report will:

- Improve the efficiency and overall internal control structure over purchasing citywide.
- Reduce the risk to the City that inappropriate or unnecessary purchases will be made and go undetected, or that City assets will be stolen.
- Better ensure that the EM Division bills the departments it serves for all the parts and outside services it purchases to repair City equipment.
- Increase the likelihood that competitive prices are paid for goods and services.
- Possibly decrease the risk of employee accidents and injuries.