

CITY OF SACRAMENTO INTERNAL AUDIT

Management Controls: Inventory & Debit Card Usage for the Department of Utilities

Report Number 2007-03





OFFICE OF THE
CITY MANAGER

CITY OF SACRAMENTO
CALIFORNIA

CITY HALL
915 I STREET
5TH FLOOR
SACRAMENTO, CA
95814-2604

PH 916-808-5704
FAX 916-808-7618

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Honorable Mayor, City Council Members, and City Manager:

The Sacramento City Auditor has completed a limited scope audit of the Department of Utilities. Due to the complexity and nature of findings discovered during the completion of audit fieldwork, two separate audit reports were issued. This report addresses the Department of Utilities' inventory and debit card usage. A separate audit report addresses the examination of the Department of Utilities' contracting practices. The inventory and debit card processes examined are the responsibility of the Department of Utilities' management. The City Auditor's responsibility is to express an opinion on management oversight and controls.

This examination was conducted in accordance with the City Council's core values and guiding principles of fiscal responsibility and accountability, as well as applicable standards contained in Government Auditing Standards, issue by the Comptroller General of the United States, with the exception of a peer review.

This report provides the Mayor, City Council, and the City Manager with an objective evaluation of the Department of Utilities' managerial controls over inventory and debit card usage.

In my opinion, the Director of Utilities or his representatives need to take immediate action to significantly increase managerial controls over inventory and departmental controls over debit card usage.

Audit conclusions were discussed in detail with the City Manager's Office, the Interim Director of the Department of Utilities, and the Director of Finance. The written responses to this report are included in the Appendix. I appreciate the courtesy and professionalism of the numerous municipal departments and their staff that cooperated and made this complex audit possible.

Martin J. Kolkin
City Auditor

Table of Contents
Management Controls: Inventory and
Debit Card Usage for the
Department of Utilities
Report Number 2007-03

<u>EXECUTIVE SUMMARY OF FINDINGS</u>	iii
<u>EXECUTIVE SUMMARY OF RECOMMENDATIONS</u>	v
<u>PRELIMINARY SECTION</u>	
Introduction	1
Two Audit Reports	1
Objective & Scope	1
Citywide Ramifications	1
<u>FINDINGS & CONCLUSIONS</u>	
1. DOU's INVENTORY CONTROLS	2
1A. Outdated Policies and Procedures	2
1B. Water Meters Inventory	2
1B1. Lack of Fundamental Physical Controls over Water Meter Inventory	2
1B2. Insufficient Controls to Detect or Prevent a Material Loss	3
1C. \$400,620 Inventory Write-Off for Fiscal Year 2007	5
1D. Year-End Inventory Valuation Contained Material Errors	5
1D1. Year-End Physical Inventory	6
1D2. Annual Receipts & Disbursements Report	6
2. RECOMMENDED REVISIONS TO CITYWIDE POLICIES, PROCEDURES, AND GUIDELINES BASED UPON DOU DEBIT CARD USAGE	7
2A. Extensive Debit Card Usage	7
2B. Detailed Debit Card Sample	8
2B1. Debit Card Purchases for Items in which Council Approved Cooperative Purchasing Agreements were in Effect	8
2B2. Poor Judgment and Oversight of Debit Card Usage	9
2B3. Use of Lost Receipt Justifications Forms and Debit Card Receipts	9
2C. Debit Card Purchases for Cameras and Camcorders	11
2D. Tracking Assets Purchased on Debit Cards	11
2E. Other Concerns – Guidelines for Food Purchases	12
<u>APPENDIX</u>	13

Executive Summary of Findings
Management Controls: Inventory and
Debit Card Usage for the
Department of Utilities
Report Number 2007-03

At the request of the Mayor and City Council and the direction of the City Manager, a limited scope examination of the Department of Utilities (“DOU”) was performed.

Two audit reports were issued due to the complexity and nature of findings discovered during the completion of audit fieldwork. This report addresses the DOU’s inventory and debit card usage. A separate audit report addresses DOU’s contracting processes.

Based upon the work performed, the City Auditor noted the following findings:

1. DOU’s INVENTORY CONTROLS

Material deficiencies exist in the Department of Utilities’ inventory controls.

1A. Outdated Policies and Procedures

The Department of Utilities’ policies and procedures were last updated in February 2001. Several policies and procedures either were never established or recorded, such as those governing inventory (refer to pg. 2).

1B. Water Meters Inventory (refer to pg. 2)

1B1. Lack of Fundamental Physical Controls over Water Meter Inventory

The Department of Utilities lacked fundamental physical controls over approximately \$10.5 million of water meter inventory purchased from May 1998 through September 2007.

1B2. Insufficient Controls to Detect or Prevent a Material Loss

The City Auditor’s preliminary estimate projected that approximately 4,492 water meters, with a projected value of \$1,352,092 could not be located. This estimate was based upon inventory information obtained from DOU’s Customer Information System. Based upon DOU’s concerns regarding inaccuracies in their Customer Information System, a consultant was hired and is in the process of performing a physical count of all water meters. However, the inability to track or locate assets represented a significant deficiency in DOU’s management control environment.

1C. \$400,620 Inventory Write-Off for Fiscal Year 2007

DOU staff recorded a \$400,620 write-off, 18%, of the \$2,177,458 ending inventory for Field Services Division. The Department Director’s approval was neither required by DOU procedures nor obtained. Additionally, the report used as a basis for the write-off contained material errors, as noted in Finding 1D of this report (refer to pg. 5).

1D. Year-End Inventory Valuation Contained Material Errors

The Field Services’ fiscal year (“FY”) 2007 inventory valuation contained material errors. These errors represented a significant deficiency¹ in controls over inventory, management oversight, and financial reporting (refer to pg. 5).

¹ Codification of Statements on Auditing Standards, AU Section 325.05, Communicating Internal Control Related Matters Identified in an Audit.

1D1. Year-End Physical Inventory

The fiscal year 2007 physical inventory contained material errors, which included failing to include over \$300,000 of inventory from the North Area Corporation Yard, inventory on rolling stock, and hydrant inventory.

1D2 Annual Receipts & Disbursements Report

The Annual Inventory Receipts and Disbursements Report included material errors such as: missing all receipts data from 07/29/06 – 10/17/06, missing all disbursements data from 08/08/06 - 10/23/06; and staff being unable to recover this data from their systems.

2. RECOMMENDED REVISIONS TO CITYWIDE POLICIES, PROCEDURES, AND GUIDELINES BASED UPON DOU DEBIT CARD PRACTICES

2A. Extensive Debit Card Usage

Twenty-six debit cardholders purchased \$574,450 of goods during calendar year 2006. Extensive usage of debit cards circumvents the designed internal controls provided by the City's financial and procurement systems (refer to pg. 7).

2B. Detailed Debit Card Sample

The period of December 2005 - March 2006 was judgmentally selected for review.

2B1. Debit Card Purchases for Items in which Council Approved Cooperative Purchasing Agreements were in Effect

\$83,809, 36%, of the \$234,231 debit card purchases sampled failed to take advantage of City Council approved Cooperative Purchasing Agreements (refer to pg. 8).

2B2. Poor Judgment and Oversight of Debit Card Usage

The use of a debit card for a \$1,428 custom retirement plaque and a \$50 memorial donation demonstrated poor judgment by employees and insufficient oversight by employees responsible for reviewing debit card purchases (refer to pg. 9).

2B3. Use of Lost Receipt Justifications Forms and Debit Card Receipts

A four months sample of debit card transactions noted twenty-two transactions, totaling \$3,729, which used lost receipt justification forms and twenty transactions, totaling \$5,004, documented with only a debit card receipt (refer to pg. 9).

Itemized receipts or invoices serve as primary support for expenditures. A debit card receipt provides the total spent, not the details of a billing document or invoice. The debit card receipt alone does not provide sufficient documentation of expenditures.

2C. Debit Card Purchases of Cameras and Camcorders

The sample of debit card usage noted five transactions, totaling \$4,583 for the purchase of cameras and camcorders. The five transactions ranged in cost from \$517 to \$1,561. Although not specifically prohibited by the current APIs, the purchase of high cost items on debit cards is a poor business practice (refer to pg. 11).

2D. Tracking Assets Purchased on Debit Cards

A judgmental sample of 30 transactions, totaling \$11,070, was selected to validate the existence and location of purchases made with debit cards. Nine items, with a value of \$2,331, 21%, were not located by Utilities staff members (refer to pg. 11).

2E. Other Concerns – Guidelines for Food Purchases

The City Auditor recommends using policies and procedures instead of guidelines to provide a direct managerial control over acceptable food purchases (refer to pg. 12).

Executive Summary of Recommendations
Management Controls: Inventory and
Debit Card Usage for the
Department of Utilities
Report Number 2007-03

The City Auditor recommends that the Director of Utilities or his representatives take immediate action to significantly increase:

1. **Managerial controls over inventory; &**
2. **Departmental controls over debit card usage.**

City Auditor's Recommendations	Action Taken by Management	Estimated Completion Date
1. The Director of Utilities take the following actions to increase managerial oversight over inventory:	Management's actions are listed below by recommendation.	Listed below by recommendation.
1A. Perform a comprehensive update of all departmental policies and procedures, including adding policies and procedures that were never previously recorded, such as inventory control (refer to pg. 2).	The Interim Director of the Department of Utilities ("IDDOU") stated that a comprehensive update of policies and procedures are currently underway. The Field Services Manager noted that inventory policies and procedures have been formalized and completed.	12/31/08
1B. Water Meters Inventory (refer to pg. 2)	Management's actions are listed below by recommendation.	Listed below by recommendation.
1B1. Install fundamental physical controls over inventory, including (refer to pg. 2): Securing facilities; Assigning accountability for each step of the inventory process; and Reconciling physical counts to perpetual inventory records.	The IDDOU concurred. The Field Services Division Manager pointed out that all water meters are now stored in a locked location with restricted access, a fence was installed to secure scrap materials at the 24 th street facility, the use of bar code technology is being examined, and new reports have been developed to provide increased accountability for materials and equipment.	Completed

City Auditor's Recommendations	Action Taken by Management	Estimated Completion Date
<p>1B2. Establish controls to prevent and detect material losses, including (refer to pg. 3):</p> <ul style="list-style-type: none"> • Continuing to utilize the Police Department to determine if unaccounted for water meters involved criminal activity, • Assigning accountability for each step of the water meter inventory process, • Performing a physical count of all water meters, • Implementing best practices for achieving accurate physical counts of inventory, and • Maintaining accurate records of all existing water meters, including installations & salvaged items. 	<p>The IDDOU concurred.</p> <p>The Field Services Division Manager pointed out that a consultant has been hired to perform a physical count of the meters. He added that once the count and analysis completed, a report would be submitted with the findings. The Field Services Division Manager added that DOU will continue to contact the Police Department on all suspected criminal activities.</p> <p>The Field Services Division Manager and the Plant Services Division Manager noted that new procedures have been established that assign accountability for each step of the inventory process.</p>	<p>12/31/08</p>
<p>1C. \$400,620 inventory write-off made without the Department Director's approval and based on faulty reports (refer to pg. 5):</p> <ul style="list-style-type: none"> • Determine the value of ending inventory, • Establish dollar thresholds requiring Department of Utilities Supervisory and/or Director authorization, and • Establish citywide dollar thresholds that require the Accounting Manager and the Finance Director's approval. 	<p>The IDDOU concurred. The Field Services Division Manager stated that once errors identified with year-end inventory are determined, adjusting journal entries would be posted.</p> <p>The Field Services Division Manager noted that a consultant has been hired to perform a water meter physical inventory.</p> <p>The IDDOU stated that the Director of Utilities approval would be required for all transactions of \$250,000 or greater.</p> <p>Representative of the City Manager's Office noted that the Accounting Manager's authorization is now required for transactions of \$100,000 or greater and the Finance Director's authorization is required for transactions of \$250,000 or greater.</p>	<p>09/30/08</p> <p>Completed</p> <p>Completed</p>

City Auditor's Recommendations	Action Taken by Management	Estimated Completion Date
<p>2B3. Require debit card holders to present itemized receipts for their expenditures (refer to pg. 9).</p> <p>The audit sample located a \$919 fluke meter and a \$529 camera supported only by a lost receipt justification form. In addition, a debit card receipt was the only documentation provided for \$1,885 of goods purchased from Cable Cisco.</p> <p>The City Auditor recommends that the City Manager or his representatives establish administrative procedures for the use of lost receipt justification forms and prohibit the use of debit card receipts as the only documentation.</p>	<p>The IDDOU stated that staff would receive refresher training on the use of a City debit card.</p> <p>The IDDOU noted that the City Manager's policies, procedures, and guidelines are under review.</p>	<p>09/30/08</p> <p>12/31/08</p>
<p>2C. Place dollar limitations on individual purchases with debit cards (refer to pg.11).</p> <p>The debit card sample noted five transactions totaling \$4,583 for the purchase of cameras and camcorders.</p>	<p>The IDDOU stated that \$1,000 limit would apply without Department Director approval. However, he noted that this matter is under review by the City Manager's Office for possible citywide applications.</p>	<p>Completed</p>
<p>2D. Develop a formal asset tracking system, such as bar-coding (refer to pg. 11).</p> <p>The Utilities' staff members could not locate 9 items in a sample of 30 transactions selected for asset verification.</p> <p>Unlocated items included a \$915 camcorder, a \$471 cellular phone, and a \$323 printer.</p>	<p>Representatives of the City Manager's Office stated that this item is under policy review on a citywide basis.</p> <p>The IDDOU further noted that staff would now be required to notify their Supervisor of missing assets.</p>	<p>12/31/07</p>

City Auditor's Recommendations	Action Taken by Management	Estimated Completion Date
<p>2E. Formalize the new meal and refreshment guidelines into specific policy and have the City Manager approve the policy as part of his Administrative Policy Instructions (refer to pg. 12).</p> <p>Additionally, the following information is recommended to be included with the documentation for every food purchase:</p> <ul style="list-style-type: none"> • The business purpose of the food; and • The printed name and signature of the purchaser and the authorizing individual. 	<p>The IDDOU noted that the City Manager's policies, procedures, and guidelines are under review.</p>	<p>12/31/08</p>

Due to the serious nature of the management control weaknesses identified in this audit, a Departmental quarterly report-back to the Mayor and City Council is recommended. Additionally, a follow-up internal audit is recommended within the next 24 months.

Preliminary Section
Management Controls: Inventory and
Debit Card Usage for the
Department of Utilities
Report Number 2007-03

INTRODUCTION

In accordance with the approved Calendar Year 2007 Audit Workplan, the City Auditor completed a limited scope examination of the Department of Utilities' managerial controls over inventory, debit cards, contracting processes, and purchasing practices.

TWO AUDIT REPORTS

Two audit reports were issued due to the complexity and nature of findings discovered during the completion of audit fieldwork. This report addresses the DOU's inventory and debit card usage. A separate audit report addresses DOU's contracting processes.

OBJECTIVE & SCOPE

This report provides the Mayor, City Council, and the City Manager with an objective evaluation of the Department of Utilities' managerial controls over inventory and debit card usage.

Records Examined

The audit included, but was not limited to the following:

- Examination of the Department of Utilities' contract files;
- Review of invoices, vendor payments, and purchasing card payments for fiscal years 2005, 2006, and 2007;
- Physical observations of internal controls, operations, and practices;
- Analytical examinations of financial data;
- Examination and verification of general ledger data; and
- Interviews and discussions with personnel from the City Clerk's Office, the Department of Utilities, the Finance Department, the City Attorney's Office, the Labor Relations Department, the Police Department, and the City Manager's Office.

This examination was conducted in accordance with the City Council's core values and guiding principles of fiscal responsibility and accountability, as well as applicable standards contained in Government Auditing Standards, issued by the Comptroller General of the United States, with the exception of a peer review.

The audit report is intended for the information and use of the Mayor, City Council, City Manager, and City Management.

CITYWIDE RAMIFICATIONS

This report focused primarily upon the Department of Utilities. Conclusions regarding other City Departments are beyond the scope of this audit. However, audit recommendations have relevance for numerous City Departments, particularly those Departments with inventory at the 24th Street Corporation Yard and those Departments that use debit cards.

Findings and Conclusions
Management Controls: Inventory and
Debit Card Usage for the
Department of Utilities
Report Number 2007-03

The audit findings and conclusions fall into the following areas:

1. DOU's INVENTORY CONTROLS and
2. DEBIT CARD USAGE

1. DOU's INVENTORY CONTROLS

Material deficiencies exist in the design and operation of the Department of Utilities' inventory controls.

1A. Outdated Policies and Procedures

The Department of Utilities' policies and procedures were last updated in February 2001. The policies and procedures require a comprehensive updating as a result of normal changes in business processes. Additionally, several policies and procedures either were never established or recorded, such as those governing inventory.

Policies and procedures provide a direct managerial control over operations. They establish specific actions to be taken to ensure that objectives are identified and that results are achieved. Policies and procedures also lessen the likelihood that unintended actions occur, such as theft or fraud.

1A. Conclusion

The City Auditor recommends that the Director of Utilities or his representatives perform a comprehensive written update of all Departmental policies and procedures.

1B. Water Meters Inventory

1B1. Lack of Fundamental Physical Controls over Water Meter Inventory

The Department of Utilities lacked fundamental physical controls over the water meter inventory. The Department purchased approximately \$10.5 million of water meters from May 1998 through September 2007.

The following basic controls were missing:

- 1) Water meters purchased and received were not routinely checked into a secured inventory area;
- 2) Water meters were not checked out from a custodian prior to removing from inventory;
- 3) Water meters not installed were not checked back into inventory; and
- 4) A physical count of the number and type of water meters was not reconciled with perpetual inventory records.

As a result, Department of Utilities' staff members were unable to determine the type and number of water meters placed in service. Additionally, the annual physical inventory of water meters was never reconciled to the number of meters that should have been in inventory, the perpetual inventory count.

The purpose of physical controls is to prevent the misappropriation of assets. Physical controls² encompass the activities that involve the physical security of assets. These controls include adequate safeguards of the assets, such as: secure facilities; accountability for inventory; and the periodic reconciliation of physical counts to perpetual inventory records³.

A consulting report, *Management Review of Inventory Process and Controls at 24th Street Corp Yard*, issued by Lorick Associates Consulting, dated January 2008, cited the need to secure and monitor all material and equipment inventory at the 24th street complex, including such items as water meters, copper piping, and scrap metals.

1B1. Conclusion

The City Auditor recommends that the Director of Utilities or his representatives perform a comprehensive review and take necessary steps to install physical controls that safeguard the Department's entire inventory, including water meters.

Additionally, the City Auditor recommends that the Director of Utilities or his representatives establish direct accountability for each step of the overall inventory process.

1B2. Insufficient Controls to Detect or Prevent a Material Loss

The City Auditor's preliminary estimate projected that approximately 4,492 water meters, with a projected value of \$1,352,092, could not be located. This estimate was based upon the best information available from DOU, the Customer Information System ("CIS") and billing system. **However, the Director of Utilities expressed concern regarding the accuracy of information obtained from his Department's Customer Information System.**

An evaluation of the entire CIS system was beyond the scope of this report. As an alternative measure, a physical count of all 32,183 water meters was recommended by the City Auditor. DOU representatives concurred and hired a consultant to locate and count all of the water meters. At the time of this report, final results from the consultant were not available. Results obtained from the consultant's report may also be used to evaluate the accuracy of the information within the CIS.

The inability to track or locate assets represented a significant deficiency⁴ in the Department of Utilities' overall management control environment.

No inventory tracking records were located to validate the number of water meters purchased and installed. Although the Department of Utilities did take an annual ending inventory evaluation, it was used solely for financial reporting purposes, not for

2 Codification of Statements on Auditing Standards, AU Section 319.110.9, Consideration of Internal Control in a Financial Statement Audit, Control Activities.

3 Perpetual inventory records are maintained daily by the addition of goods received and the deduction of goods when used. This method, as opposed to a yearly or monthly calculation, allows for continuous or perpetual inventory records.

4 Codification of Statements on Auditing Standards, AU Section 325.05, Communicating Internal Control Related Matters Identified in an Audit.

inventory control purposes. Additionally, the annual physical inventory contained significant errors and was insufficient to reconstruct the actual value of the unaccounted for water meters.

A calculation was performed as noted in Table One of this report to estimate the number and cost of the unaccounted for water meters. Water meters used by the Department of Utilities ranged in cost from \$150 to \$3,800 per unit. Since it was not possible to determine which meters were unaccounted for, an average cost per meter was calculated and used for estimating the cost associated with the missing water meters, refer to Table One.

Table One
Preliminary Cost Estimate and Number of
Unaccounted for Water Meters
As of September 2007

Description	Source	Number
Purchases 5/1998 – 9/2007	Vendor Invoices	32,183
Less		
Actual Installations	DOU's Customer Information System *	26,584
Inventory on Hand	Utilities 9/2007 Physical Count	1,107
Unaccounted for Water Meters	Calculated	4,492
Average Cost per Meter	a	\$301
Cost Estimate for Unaccounted for Water Meters	Calculated	\$1,352,092

a - \$9,691,181 for all water meter received through 09/30/07 divided by 32,183 units = \$301 per meter.

* - The information obtained from the CIS billing system was downloaded directly by DOU representatives to determine the total number of water meter installations.

1B2. Conclusion

The City Auditor recommends that the Director of Utilities or his representatives:

- Continue to utilize the services of the City's Police Department to determine if the unaccounted for water meters involved criminal activity;
- Establish and assign direct accountability for each step of the overall water meter inventory process;
- Implement procedures for achieving accurate physical counts of inventory;
- Perform a physical inventory count of all water meters;
- Reconcile the perpetual inventory records to the physical count;
- Maintain accurate records of all water meters, include installations, retired units, and salvage meters;
- Locate and correct data errors existing in CIS. The physical inventory of all water meters will serve as basis for verifying CIS water meter information.

1C. \$400,620 Inventory Write-Off for Fiscal Year 2007

The Department of Utilities recorded a \$400,620 write-off, approximately 18%, of the \$2,177,458 ending inventory for the Field Services Division, Water Distribution. The approval of the Director of Utilities was neither required by DOU's procedures nor obtained.

The report used as a basis for DOU's \$400,620 write-off contained material errors, as noted in Finding 1D of this report.

This entry was prepared by a Department of Utilities Administrative Analyst and approved by a Department of Utilities Program Manager. The City's Accounting Division approved and entered the transaction in the financial system. **Sufficient internal controls would have routinely red-flagged such a large and unusual transaction.**

Utilities staff members immediately began the process of recalculating this inventory write-off.

Table Two
History of Field Services - Water Distribution's
Year End Inventory Write-Off
Fiscal Years 2005 - 2007

Fiscal Year	Inventory Gain or <Loss>	Percentage of Ending Inventory
2005	\$ 108,210	9.6%
2006	86,663	4.3%
2007	<400,620>	<18.4%>

Source: City of Sacramento Financial System

1C. Conclusion

The City Auditor recommends that the Director of Utilities or his representatives take appropriate steps to accurately determine the value of Field Services' ending FY 2007 inventory and then make appropriate accounting adjustments.

The City Auditor further recommends that the Director of Utilities or his representatives require supervisory authorization for material accounting entries.

The City Auditor also recommends that the Finance Director establish dollar thresholds that require the Accounting Manager's approval and higher thresholds that require the Finance Director's approval, for example \$100,000 and \$250,000 prospectively.

1D. Year End Inventory Valuation Contained Material Errors

The Field Services' fiscal year ("FY") 2007 inventory valuation contained material errors. This inventory valuation was used in the City's Comprehensive Annual Financial Report ("CAFR") and for project costing purposes. Errors in this report also resulted in incorrect project costing for capital improvement projects that used inventory obtained from the Field Services Division, Water Distribution.

This represented a significant deficiency⁵ in controls over inventory, management oversight, and financial reporting.

1D1. Year-End Physical Inventory

The Field Service's fiscal year 2007 year end physical inventory contained material errors such as:

- Failing to include over \$300,000 of inventory from the North Area Corporation Yard, inventory on rolling stock, and hydrant inventory;
- Numerous incorrect unit costs, which included 17 unit cost of \$0.00; and
- 3 inventory items with negative quantities.

1D2 Annual Receipts & Disbursements Report

The Field Services' Annual Inventory Receipts and Disbursements Report included the following material errors:

- Missing all receipts data from 07/29/06 – 10/17/06 and missing all disbursements data from 08/08/06 - 10/23/06. Additionally, DOU staff was unable to recover this data from their information systems;
- Inaccurate calculations of unit cost times quantity in receipts report;
- Incorrect inclusion of numerous disbursements in receipts report;
- Inaccurate inclusions of transfers between warehouses in receipt and disbursement reports; and
- Incorrect use of the system input date as one of the criteria for generating reports, instead of using the actual date of the transaction.

Utilities staff members immediately began the process to resolve these issues. Additionally, Macias, Gini, & O'Connell, CPAs, the City's external auditors, noted in their *Report to Management*, for FY 2007, that the City does not have a consistent system for taking periodic inventory counts.

1D. Conclusion

The City Auditor recommends that the Department of Utilities be restructured to provide greater managerial oversight.

The City Auditor also recommends that the Director of Utilities or his representatives:

- Take appropriate measures to determine the FY 2007 inventory valuation for the Field Services Division;
- Make associated adjusting and correcting journal entries;
- Establish policies and procedures for all Department of Utilities inventory;
- Assign direct accountability for each step of the inventory process;
- Perform monthly inventory calculations rather than an annual calculation; and
- Have warehouse staff examine unit costs for reasonability prior to forwarding reports to administrative staff.

⁵ Codification of Statements on Auditing Standards, AU Section 325.05, Communicating Internal Control Related Matters Identified in an Audit.

Field Services staff agreed that the methods used to query the system information for the year-end inventory valuation lacked a standard procedure or practice to ensure consistency in reporting. As a result, multiple nonstandard information queries occurred that produced nonstandard and incomplete results.

1. STATUS OF MANAGEMENT ACTION

The City Manager's Office and DOU took numerous steps to address deficiencies noted in the audit. These actions included:

- Increased physical security of inventory, including restricting access and the installation of chain link fencing;
- New inventory policies and procedures were developed;
- A physical inventory of all water meters in the City is being conducted;
- The year-end inventory process was standardized;
- Errors in year-end inventory reports were identified and corrected; and
- New protocols are in place prior to writing-off inventory.

The Finance Director noted that accounting entries of \$100,000 or greater are now approved by the Accounting Manager and all entries of \$250,000 or greater are now approved by the Finance Director.

2. RECOMMENDED REVISIONS TO CITYWIDE POLICIES, PROCEDURES, AND GUIDELINES BASED UPON DOU DEBIT CARD PRACTICES

2A. Extensive Debit Card Usage

Twenty-six Department of Utilities' debit cardholders purchased \$574,450 of goods and services, from 636 vendors, during calendar year 2006. Annual vendor payments ranged from \$2 to \$10,931. No single transaction exceeded \$5,000.

Cardholders' monthly spending limits were established without written criteria. Cardholders' monthly spending limits were set at a range of \$1,000 up to \$15,000. Additionally, one cardholder, a storekeeper, actual expenses were \$141,586 or 25% of the total debit card expenditures for the year.

The City of Sacramento, Purchasing Card Program, User's Guide, states:

The purpose of the City of Sacramento's Purchasing Card Program (The Program) is to establish an efficient, cost-effective method of purchasing and paying for small dollar transactions.

2A. Conclusion

Extensive usage of debit cards circumvents the designed internal and managerial controls provided by the City of Sacramento's established financial and procurement systems. **The City Auditor recommends that the Director of Utilities or his representatives limit debit card purchases to small incidental purchases, not regular operating expenses.** Additionally, the City Auditor recommends that the Director of Utilities or his representatives establish written criteria for assigning cardholder monthly spending limits.

The City Auditor recommends that the City Manager or his representatives reevaluate Purchasing Card Program to ensure that the program is meeting its intended purpose.

2B. Detailed Debit Card Sample

The period of December 2005 through March 2006 was judgmentally selected for detailed review. Each of the 802 debit card transactions, with an aggregate cost of \$234,231, was examined. These costs were incurred by 29 Department of Utilities' debit cardholders.

2B1. Debit Card Purchases for Items in which Council Approved Cooperative Purchasing Agreements were in Effect

At least 36% of debit card purchases for the Department of Utilities failed to take advantage of City Council approved Cooperative Purchasing Agreements. Best practices dictate maximizing economic efficiencies and obtaining discounts for volume purchasing, particularly for aggregate citywide purchases, in excess of \$100,000, and where Mayor and City Council approved cooperative purchasing agreements are in effect.

Table Three below notes that at least 36% of the sampled transactions could have used existing City Council approved cooperative purchasing agreements. Additionally, the argument for speed and ease of procurement become less persuasive as the dollar expenditure of the purchased goods becomes more costly.

**Table Three
Sample Debit Card Purchases
Identified Where Council Approved
Cooperative Purchasing Agreements
Were in Effect**

Description	Dollar Amounts on Debit Cards	Percentage of \$234,231 Sample	City Council Approved Cooperative Purchasing Agreement
Tools	\$68,792	29%	Grainger \$ 350,000 Graybar \$ 200,000
Computers	11,564	5%	Multiple Vendor Annual Agreements \$7,000,000
Office Supplies	1,915	1%	Corporate Express \$1,600,000
Wireless	1,538	1%	AT&T, Nextel, & Verizon Agreements \$1,500,000
Totals	\$83,809	36%	

Source: Debit Card Receipts and City Clerk Files.

2B1. Conclusion

The City Auditor recommends that the Director of Utilities or his representatives take appropriate steps in maximizing economic efficiencies and obtaining discounts, particularly where Mayor and City Council approved cooperative purchasing agreements are in effect.

The City Auditor also recommends that the City Manager or his representatives establish policy that requires Departments to take advantage of Mayor and City Council approved cooperative purchasing agreements

2B2. Poor Judgment and Oversight of Debit Card Usage

The City Auditor noted the following transactions, while not expressly prohibited by municipal policy, demonstrated poor judgment by Department of Utilities' employees. Additionally, the transactions cited were examined and approved by employees authorized for reviewing monthly purchases.

- **Retirement Plaque** – In December 2005, a Department of Utilities Supervisor purchased a \$1,428 custom retirement plaque for a long-term city employee. The Supervisor did not obtain an estimate prior to authorizing the plaque, nor did the Supervisor obtain approval prior to paying for the plaque.

On April 30, 2008, a \$1,428 personal check was submitted by a DOU employee to reimburse the City for the cost of the retirement plaque.

- **Memorial Donation** – In April 2006, a \$50 memorial gift was purchased on a City debit card. The donation was to the American Cancer Society from the Department of Utilities, honoring a deceased City employee.

2B2. Conclusion

The City Auditor recommends that the Director of Utilities establish greater management oversight, including training, over reviewing debit card purchases. Additionally, due to the extravagant cost of the retirement plaque, the City Auditor recommended the repayment of the \$1,428 and that the appropriate officials determine whether employee discipline is warranted. As previously noted, on April 30, 2008, a \$1,428 personal check was submitted by a DOU employee to reimburse the City for the retirement plaque costs.

The City Auditor recommends that the City Manager or his representatives establish new Administrative Policy Instructions (“API”) which includes policy direction on recognition of retiring employees, bereavement acknowledgements, and acceptable spending of public funds on employees. Additionally, once the policy has been implemented, the City Auditor recommends providing training to employees.

2B3. Use of Lost Receipt Justifications Forms and Debit Card Receipts

The sample of four months of debit card transactions noted twenty-two transactions, totaling \$3,729, which used lost receipt justification forms and twenty transactions, totaling \$5,004, documented with only a debit card receipt.

Original itemized receipts or invoices serve as primary support for expenditures.

Lost receipt justifications forms for occasional and diminutive purchases, under \$100, is not an uncommon practice. A policy decision by management

is conventionally made to not pursue normal documentation requirements due to the small dollar amount of the transaction. However, consideration must also be given to the frequency of the filing of lost receipt justification forms by employees.

A debit card receipt provides the total spent, not the details of a billing document or invoice. As a result, the debit card receipt alone does not provide sufficient documentation of expenditures⁶.

**Table Four
Sample Debit Card Purchases -
Lost Receipt Justification Forms
and Debit Card Receipts**

Description	Purchases Under \$100	Purchases between \$101 to \$499	Purchases Greater than \$500	Total Number of Purchases
Lost Receipt Justification	12	8	2	22
Debit Card Receipt	11	6	3	20

Source: Debit Card Receipts.

Purchases Greater than \$500

Lost receipt justification – A lost receipt justification form was filed for the purchase of a \$919 fluke meter and another for the purchase of a \$529 camera. The City Auditor noted that copies of these invoices were neither requested nor obtained from the vendors.

Debit Card Receipt – Debit card receipts were filed for the purchases of \$1,885 of merchandize from Cable Cisco, \$808 of items at Jr’s Texas BBQ, and \$625 of items from Original Perry’s. **As previously noted, debit card receipt do not provide an itemized listing of purchases. As a result, the actual items purchased with the debit cards could not be determined from the supporting documentation.**

Other Observations

A review of the debit cardholders, with lost receipt justification forms or only debit card receipts, showed a pattern of repeat filers. One individual filed ten of the twenty-two lost receipt justifications during the period sampled. While one individual filed five of the twenty debit card receipts.

2B3. Conclusion

The City Auditor recommends that the Director of Utilities or his representatives hold debit card holders accountable for appropriate documentation of items purchased with a debit card.

The City Auditor recommends that the City Manager or his representatives revise the existing policies for debit cards to include guidelines for lost receipt justifications, including the frequency that lost receipt justifications can be filed by

6 Debit card receipts alone without invoice or receipt details were previously cited in different City Auditor’s Report, The Revenue Division’s Cash Controls, dated March 2007, page 10.

the same individual, and specific requirements for original itemized receipts, in addition to the debit card receipts.

The Finance Director noted that a consultant recently provided best practices recommendations for the APIs and the recommendations were under review.

2C. Debit Card Purchases of Cameras and Camcorders

The sample of four months of debit card usage noted five transactions, totaling \$4,583 for the purchase of cameras and camcorders. The five transactions ranged in cost from \$517 to \$1,561.

Although not specifically prohibited by the current APIs, the City Auditor believes the purchase of high cost items on debit cards is a poor business practice.

2C. Conclusion

The City Auditor recommends that the City Manager or his representatives direct the Finance Department to revise the existing API for debit cards to include dollar limitations on individual purchases.

2D. Tracking Assets Purchased on Debit Cards

A judgmental sample of 30 transactions, totaling \$11,070, were examined to validate the existence and location of purchases made with debit cards. Nine items, with a value of \$2,331, 21% of the value of the sample, were not located by Utilities staff members.

The Department of Utilities did not have a formal method, such as radio frequency identification or bar-coding, to track the location of the asset.

**Table Five
Assets Purchased on
Debit Cards that
Could not Be Located**

Description	Dollar Value
Camcorder	\$915
Cellular Phone	471
Office Jet Printer	323
Camera	212
Grinder	151
Cellular Phone	86
Walkie-Talkies, 2 pair	86
Tool Case	52
Dry-Vac	35
Total	\$2,331

2D. Conclusion

The City Auditor recommends that the Director of Utilities or his representatives develop an asset tracking methodology, such as radio frequency identification or bar-coding, to track the location and custodian of the asset.

The City Auditor also recommends the City Manager or his representatives develop a citywide policy regarding tracking of assets.

2E. Other Concerns – Guidelines for Food Purchases

A new policy establishing guidelines for using City funds to purchase meals and light refreshments was adopted and posted on the City's intranet website.

It is the City Auditor's opinion that guidelines leave the food purchase to the individual employee's discretion. Policies and procedures provide a direct managerial control over acceptable food purchases. This managerial control also provides assurances that unintended actions do not occur, for example dollar limitations on food for meetings, who is authorized to purchase food, and which situations are specifically inappropriate to make food charges.

2E. Conclusion

The City Auditor recommends that the City Manager or his representative formalize the new meals and light refreshment guidelines into specific policy and have the City Manager approve the policy as part of his APIs.

Additionally, the City Auditor recommends that the business purpose of every food purchase be specifically stated on the expenditure documentation, the name and signature of the purchaser is required, and the supervisor's approving signature also is required on all food purchases.

2. STATUS OF MANAGEMENT ACTION

The City Manager's Office and DOU took numerous steps to address deficiencies noted in the audit. These actions included:

- DOU debit cardholders received refresher training on City debit card policies and procedures;
- The \$1,428 for the retirement plaque was repaid by the DOU employee who made the original purchase;
- DOU staff would explore ways to maximize economic efficiencies and take advantage of Mayor and City Council approved cooperative purchase agreements instead of using debit cards;
- Greater scrutiny of lost receipt forms;
- Requiring actual itemized receipts, in addition to debit cards receipts; and
- Exploring asset tracking systems.

APPENDIX

Department of Utilities' Response



OFFICE OF THE
CITY MANAGER

CITY OF SACRAMENTO
CALIFORNIA

CITY HALL
915 I STREET
5TH FLOOR
SACRAMENTO, CA
95814-2604

MEMORANDUM

PH 916-808-5704
FAX 916-808-7618

DATE: May 30, 2008

TO: Martin Kolkin, City Auditor

FROM: Marty Hanneman, Assistant City Manager / Interim Director of the Department of Utilities *MH*

SUBJECT: **RESPONSE TO THE INTERNAL AUDIT OF THE DEPARTMENT OF UTILITIES**

The Department of Utilities ("DOU") acknowledges the findings contained in the internal audit report. DOU concurs with the audit findings and supports the report's recommendations. These recommendations include actions to significantly increase managerial oversight of contracts and projects, physical and organizational improvements to enhance processes and internal controls, and a strong commitment to inter-departmental collaboration in support of the City's core values of accountability, fairness, and transparency in procurement practices and oversight.

The Department of Utilities has already undertaken a wide range of improvements designed to improve business practices, and increase management oversight of projects, procurement practices, and compliance with City policies.

Management Action

The Department of Utilities took numerous steps to correct items noted in the audit:

- The Field Services Division of Department of Utilities increased the physical security of inventory, including restricting access and the installing fencing;
- New policies and procedures are being developed;
- A physical inventory of all water meters in the City is underway;
- Investigation and corrective action on inaccurate inventory reports occurred;
- A staff report was submitted to the Mayor and City Council on 05/27/08 regarding the payment of outstanding Badger Water Meter invoices;
- Sole sourcing of water meters will be discontinued. A request for proposal is planned to solicit proposals for meter reading technology;
- Contracted backhoe services are restricted to emergency use with Superintendent's approval;
- A consultant was hired to assist in the updating of APIs; and
- The Department of Utilities anticipates that numerous procedural problems would be resolved with the implementation of City's new financial/human resource system, which requires specific protocols before allowing a transaction to process.