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CITY OF SACRAMENTO

DEPARTMENT OF FINANCE

JACK R. CRIST
Director of Finance

February 3, 1986
FA:86063:JRC:KMF

ADMINISTRATION
BUDGET DIVISION
REVENUE DIVISION
ACCOUNTING DIVISION

Budget and Finance Committee
Saramento, California

Honorable Members in Session:

SUBJECT: Price Waterhouse Recommendation for Improving
Internal Accounting Controls

SUMMARY

Attached for the Committee's information is a routine report received from Price Waterhouse. This report is for information and no Committee action is required. City staff will implement those items in which concurrence is indicated.

Should the Committee desire to cover any of the areas noted in greater detail, I will arrange for appropriate City staff and/or Price Waterhouse to attend a subsequent Committee meeting.

Respectfully submitted,

JACK R. CRIST
Director of Finance

Attachment

APPROVED FOR COMMITTEE INFORMATION:

SOLON WISHAM, JR.
Assistant City Manager

cc: City Department Heads

FINANCIAL DATA

The funding required for these positions (\$50,000) is available within the Department's budget. Contracts within the Professional Services Account will be curtailed or deferred to make funds available. No additional appropriation from the General Fund will be required to fund this request.

RECOMMENDATION

It is requested that the City Council adopt the attached resolution providing for continuation of six additional Inspector positions and one clerical position, and transfer of funds.

Respectfully submitted,



Mac Mailes, Director
Planning and Development

RECOMMENDATION APPROVED:

Walter J. Stipe, City Manager

Attach/

February 11, 1986
All Districts

RESOLUTION NO.

ADOPTED BY THE SACRAMENTO CITY COUNCIL ON DATE OF

RESOLUTION EXTENDING LIMITED-TERM BUILDING INSPECTORS POSITIONS

WHEREAS, the continuation of additional limited-term staffing is needed to meet field inspection workload demands;

BE IT RESOLVED BY THE COUNCIL OF THE CITY OF SACRAMENTO:

1. Six Building Inspector I (Limited-Term - February 15 to June 30, 1986) positions and one Typist Clerk II (Limited-Term - February 15 to June 30, 1986) position be added to the Inspections Division.
2. The City budget for Fiscal Year 1985-86 is hereby amended by transferring \$50,000 from the Planning Division's budget 1-01-3525-0000-4258 to the Inspections Division's budget 1-01-3530-0000-4101 for the purpose stated above.

MAYOR

ATTEST:

CITY CLERK



CITY OF SACRAMENTO

RECOMMENDATIONS TO IMPROVE
INTERNAL ACCOUNTING CONTROLS
AND ADMINISTRATIVE EFFICIENCIES

OCTOBER 30, 1985

Price Waterhouse



October 30, 1985

To the Honorable Mayor and the
City Council of the City of
Sacramento

We have examined the financial statements for the City of Sacramento for the year ended June 30, 1985, and have issued our report thereon dated October 30, 1985. As part of our examination, we made a study and evaluation of the City of Sacramento's system of internal accounting control to the extent we considered necessary to evaluate the system as required by generally accepted auditing standards. The purpose of our study and evaluation was to determine the nature, timing and extent of the auditing procedures necessary for expressing an opinion on the City's financial statements. Our study and evaluation was more limited than would be necessary to express an opinion on the system of internal accounting control taken as a whole.

The management of the City of Sacramento is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles.

Because of inherent limitations in any system of internal accounting control, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

Our study and evaluation made for the limited purpose described in the first paragraph would not necessarily disclose all material weaknesses in the system. Accordingly, we do not express an opinion on the system of internal accounting control of the City

October 30, 1985
City of Sacramento
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of Sacramento taken as a whole. However, our study and evaluation disclosed no condition that we believed to be a material weakness.

The following recommendations relate to certain conditions noted during our examination. While none of the conditions described in these recommendations represents, in our judgment, a material weakness in the City's system of internal accounting control, we believe the recommendations will be useful to you in improving your overall system.

We would like to take this opportunity to commend the City of Sacramento, and particularly those individuals in the Department of Finance and the Treasurer's Office, for their significant efforts in successfully resolving many of the problems in the area of cash and investments accountability. This was a long and arduous task, but the benefits will be realized many times over. The improved level of recordkeeping and information available has facilitated our audit of the current year's financial statements and allowed us to complete our work in a more timely manner.

We wish to express our appreciation for the courtesy extended by the City of Sacramento's employees during the course of our examination. If you have any questions about these recommendations or if we can be of any assistance in their implementation, please do not hesitate to contact us.

This report is intended solely for the use of management and should not be used for any other purpose.

Yours very truly,

Price Waterhouse

CITY OF SACRAMENTO
RECOMMENDATIONS TO IMPROVE
ACCOUNTING CONTROLS AND
ADMINISTRATIVE EFFICIENCIES

RECOMMENDATION 1:

General controls surrounding the computer system should be strengthened.

The City of Sacramento relies increasingly upon automated data processing techniques to record and maintain its financial information. As the City's EDP capabilities become more sophisticated, the importance of overall general internal controls surrounding this function become increasingly important as one means of safeguarding the integrity of the City's automated financial reporting system from such risks as misuse or destruction of important information. Accordingly, we offer the following recommendations for your consideration:

- Formalize an equipment backup plan.

Although an informal agreement exists with the State Board of Equalization regarding use of their data processing facilities should the City's facilities not be available for an extended period of time, no formal plan or agreement has been documented or tested.

We believe that a formal equipment backup plan is required to ensure an effective and rapid recovery from an interruption in processing capabilities. Such a plan should specify a processing time schedule outlining when each of the City's major systems would be run. In addition, each system should be tested at the backup site before a disaster occurs. The adequacy of the present arrangement should be reevaluated as the City contemplates implementing a new computerized accounting system.

- Store a complete set of system and program documentation off-site.

The City of Sacramento maintains current system and program documentation on its word processing system; duplicate diskettes are maintained for backup. We recommend that an additional copy be made of the diskettes and stored off-site along with the off-site system backup. In addition, a procedure should be developed to refresh the diskettes on a regular basis (i.e., monthly) or as significant changes are made to the documentation.

- Changes to the operating system should be tested and approved by someone independent of the person making the changes.

The Computer Systems Specialist has sole responsibility for implementing and testing changes to the operating system. Because of the potential significance of some operating system changes, we recommend that testing and approval of changes to the operating system be performed by someone independent of the person implementing the changes.

- Users should supply test data and verify the results of tests before changes to existing programs are made.

For systems other than payroll, the Data Processing Department currently uses copies of production files to test changes. In order to obtain assurance that program changes produce the desired results, users requesting changes should also submit test data, where practical, that will sufficiently test the contemplated changes. In addition, the user should be responsible for formally approving the results of the test runs by signing the output before the changes are placed in the production environment.

Management Response:

- Formalize an equipment backup plan.

The Department of Data Processing will enter into a formalized equipment backup plan with an outside organization that has similar equipment. Tests of each of the City's major batch systems will then be run on the backup equipment.

- Store a complete set of system and program documentation off-site.

The City of Sacramento Data Processing Department has microfilmed all of the current system and programming documentation on updateable microfilm. This microfilm is stored offsite for backup purposes. As changes are made to the current documentation, those changed pages or complete procedures are individually microfilmed and are used to update the off-site microfilm file.

- Changes to the operating system should be tested and approved by someone independent of the person making the changes.

A policy has been established in the Department of Data Processing that requires all mainframe computer operating system changes made by the Computer Systems Specialist to be reviewed by the Operations Manager prior to implementation. This policy will be strictly enforced.

- Users should supply test data and verify the results of tests before changes to existing programs are made.

As a part of the Data Processing Department's policy and procedures manual, Section 10.2.3, System Testing Synopsis, there are guidelines covering all phases of testing. Although this procedure has been in place, it has not been enforced as rigidly as it should. This practice will be changed immediately, and the procedure will be enforced.

RECOMMENDATION 2:

Procedures surrounding the issuance and processing of purchase orders should be redesigned and interfaced with the proposed new computerized accounting system.

During the course of our examination, we noted that certain changes have been made in the current system to expedite the issuance of purchase orders. However, the mechanics of purchase order generation have not been altered to reflect these changes within the system. As the City contemplates the acquisition of a new computerized accounting system, the purchase order function should be one of the systems considered for redesign and interface with the new financial management system.

An effectively integrated system could result in significant decreases in the time required to process purchase orders, thereby enhancing administrative efficiencies, such as the following:

- Individuals requesting items to be purchased would receive requested goods or services more quickly, resulting in less resistance to the use of purchase orders.
- Time required by accounting and purchasing personnel to process purchase orders would be reduced, thereby freeing their time for other tasks.

Management Response:

The Department of General Services agrees with Price Waterhouse's recommendation to improve the administrative efficiency with the issuance and processing of purchase orders. General Services will be exploring implementation options as a part of revising our Financial Management Information System.

RECOMMENDATION 3:

Blank checks used for the on-line check write capability should be more adequately safeguarded during the day.

It is current practice in the Accounting Division to keep a large number of blank checks next to the terminal used for on-line check

write functions. When checks are not actually being printed, they should be kept under lock and key. This will result in a greater number of line-up voids; however, this cost is minor in relation to the potential cost should checks be used for unauthorized purposes.

Management Response:

Removing and reinserting checks requires voiding two checks each time the change is made. This would waste approximately six checks daily due to the average number (3) of specials written each day. The best solution would be to secure checks and machinery in a locking device or, more preferably, in a secured area with limited access; however, a satisfactory device, at a reasonable cost, has not been located nor is any space available in the Division to accommodate machine security. The system produces extensive reports as to user and check numbers and this data is reviewed daily by management. The reports include data as to operator identification and checks written. Additionally, the purpose of the check write system is to provide for expedient issuance of checks and constant removal of checks will delay the process. Therefore, until proper security equipment can be obtained or site revisions made, it is necessary to continue our current practices.

RECOMMENDATION 4:

Internal controls surrounding cash at the City of Sacramento golf courses should be strengthened.

As a part of our current year's examination, we visited the City's golf courses. As a result of these visits, we formulated the following recommendations designed to strengthen internal controls over cash collections at the courses:

- Due to the relatively few employees at the Haggin Oaks Golf Course, there is a lack of segregation of duties. We believe one way to mitigate this situation is for the shop manager to review the City revenue reconciliations and the bank deposits on a periodic basis.
- Because of the relatively large amounts of cash collected daily, deposits should be made on a daily basis for the Haggin Oaks Golf Course. Currently, deposits are made twice a week and may aggregate \$12,000 to \$16,000 individually.
- Controls should be strengthened over cash register security at the Bing Maloney and Haggin Oaks Golf Courses. During busy periods, the cash register is often left open for convenience. This could potentially lead to transactions not being recorded or to misappropriation of funds.

- Deposits should be made on a daily basis for the Bing Maloney and William Land Park Golf Courses. Currently, the Loomis armored truck makes a daily stop at both courses, although deposits are not always made. Time delays in making deposits of up to eight days were noted. Implementing the procedure of making daily deposits would result in the following benefits:
- Better utilization of the Loomis armored car pick-up service
- Minimization of the possibility of losing City funds
- Minimization of the possibility of City funds being borrowed for personal use
- Improved cash management

Management Response:

Management concurs. Steps have been initiated to strengthen the internal controls, including periodic checks of the cash and sales activity, run down inspections by management and review by the City's Internal Auditor.

RECOMMENDATION 5:

Internal controls with respect to checks received at the customer service desk in the Water and Sewer Division should be implemented.

As a result of observations made during the visit to the Water and Sewer Division, the following recommendations are presented for your consideration, implementation of which would improve the system of internal controls surrounding checks received at the customer service desk:

- Checks received through the mail should be recorded in a log prior to distribution. Before delivering the weekly deposit to the Revenue Division cashiering counter, the office supervisor should compare the log with checks on hand and included in the deposit. Checks received over the counter should be compared with the cash receipt book. This would help ensure that all deposits are intact at the time of deposit.
- It is the current practice not to restrictively endorse checks received until they are sent to the Revenue Division for deposit. To safeguard checks against inappropriate negotiation, all checks should be restrictively endorsed immediately upon receipt.
- All checks processed each day should be transferred to the safe located in the administration building for safekeeping.
- Once the new main building is complete, consideration should be given to further segregating duties and responsibilities in the

area of cash receipts. One possibility would be for the Clerk III and the Clerk-Typist I to be responsible for over-the-counter transactions. The Office Supervisor should reconcile the week's receipts against the work order copies retained at the customer service desk. The Administrative Assistant II could deliver the weekly deposit to the Revenue Division and should have no other cash receipt responsibilities.

Management Response:

- Agree with concept and have instituted procedure per the recommendation.
- Procured new stamp and have been restrictively endorsing all checks.
- Effective immediately, will institute recommendation.
- Once the new building is completed, there will be a more formal assignment of over-the-counter responsibilities.

RECOMMENDATION 6:

Internal controls surrounding cash transactions at the Planning Department should be strengthened.

During the course of our work performed at the Planning Department, we formulated the following recommendations, implementation of which should enhance the current system of internal control surrounding cash receipts:

- Deposits awaiting armored car pick-up are currently kept in an unlocked drawer in the Planning Department. In order to ensure that deposits are adequately safeguarded, a key-locked drawer should be used to store deposit bags while awaiting armored car pick-up.
- When a check is sent with plans submitted for approval, the check accompanies the plans through the approval process and is not deposited until such time as the plans are approved. This practice could result in checks becoming lost or misplaced. We believe the clerk who opens the mail should enter all checks into a log. Any plans submitted for approval should then be forwarded to the building inspector with the plans marked as "paid." All checks for the day and a copy of the check log should then be forwarded to the individual who prepares the deposit.

Management Response:

- The Planning and Development Department agrees that deposits awaiting armored car pick-up should not be kept in an unlocked drawer. A lock has been installed in a cabinet drawer at the cashier's work station.

- The Planning and Development Department agrees with Price Waterhouse's concern over the practice of not depositing a check that is sent with plans submitted for approval until such time as the plans are approved. Effective immediately, checks will be deposited on the day of receipt.

RECOMMENDATION 7:

Passwords granting user access to the computer should be changed periodically.

On-line processing and inquiry capabilities were added to the check write function on the computer system during the current fiscal year. Access to the terminal is controlled through the use of passwords. However, the effectiveness of the control is somewhat diminished in that passwords have not been changed since the new capabilities became operational. Not changing passwords regularly and frequently increases the risk that unauthorized individuals will gain access to the computerized accounting records and make unauthorized changes to the check records.

To reduce the exposure that unauthorized transactions will be processed through the system, user passwords should be changed on a periodic and frequent basis, and when an employee with access to the system is terminated or otherwise leaves the employ of the Accounting Division.

Management Response:

Management concurs and all passwords will be changed periodically.

RECOMMENDATION 8:

Procedures over the handling of stop payment and reissued checks should be formalized and standardized.

Each accountant in the Accounting Division handles the accounting for stop payments and reissuance of checks in a different manner. Such inconsistency could lead to incorrect journal entries being posted, thereby erroneously altering cash balances. A standard procedure for these items should be adopted and implemented.

Management Response:

Management concurs. Currently all stop payments and reissues of cancelled checks are being handled by two employees. This change has assured that all transactions in relation to stop payments and reissues are being properly recorded.

RECOMMENDATION 9:

Procedures surrounding the recording of fixed asset acquisitions and disposals should be improved.

Our testing in both the current and prior years has revealed that postings to the fixed asset computerized detail report have not always been made on a timely basis. This time lag increases the level of effort necessary to balance the subsidiary fixed asset report to the fixed asset balances recorded in the general ledger. In addition, depreciation expense is potentially misstated and the possibility of failing to record an asset acquisition or disposal in the subsidiary detail records is increased.

To correct this problem, an individual within the Accounting Division should be assigned responsibility for accumulating and posting fixed asset activity to the computerized fixed asset subsidiary ledger and for reconciling this report to the general ledger every month. This reconciliation should be reviewed and approved by the accounting officer or the chief accountant.

Management Response:

Management concurs with this finding; however, our current system has presented some cumbersome problems with reconciling and updating. These problems have been discussed with appropriate data processing staff and some solutions are available. Additionally, the City intends to include an integrated fixed asset module in the proposed Financial Management Information System.

RECOMMENDATION 10:

Controlled payoffs should be performed periodically throughout the year.

To provide additional assurance that supervisors and other individuals involved with payroll preparation do not enter fictitious employees and/or payroll information into the system, unannounced controlled payoffs should be performed periodically. The payoffs can be performed on a sample basis by department, but the schedule of payoffs should be determined on a random basis so that they are truly a surprise. The payoffs should be conducted by individuals with no input duties to the payroll process and no supervisory responsibilities (e.g., the internal auditor).

The controlled payoff procedure not only provides additional assurance that all payroll disbursements are to bona fide employees, but it also provides a psychological barrier against attempts to make improper payroll disbursements.

Management Response:

Management agrees with this recommendation. The Internal Auditor will plan controlled payoffs for the coming periods.