Office of the City Auditor

INFORMATION CALENDAR
November 17, 2015

To: Honorable Mayor and Members of the City Council

From: Ann-Marie Hogan, City Auditor

Subject: Tougher Budget Decisions Five Years Later

SUMMARY
Tonight's agenda includes the City Manager's report *Fiscal Year 2015 Results and FY 2016 First Quarter Budget Update*. As we explained in last year's Tough Budget Decisions Four Years Later, Council must take further action on unfunded and underfunded needs:[1]

- **Employee benefit-related future costs** – estimated at 77% funded in our 2010 audit[2] and updated in the City Manager's 2/24/15 Projections of Future Liabilities report.[3]

- **City Infrastructure needs** – estimated at over $500 million in the City Manager's Potential Ballot Measures action item on 2/18/12.[4]

- **Replacement of FUND$** – the City's core enterprise and financial software was not included in the 2012 infrastructure projection. According to a 3/25/14 report issued by the Department of Information Technology, the estimated cost to replace the FUND$ system in 2010 was over $7 million.[5]

For several years, the Auditor's Office has been setting aside salary savings to invest in replacement of the FUND$ payroll/personnel software, which remains underfunded. Our upcoming audit of the City's reserves will provide valuable information on how to plan for long-term needs by being fiscally responsible with the City's reserve balance.

CURRENT SITUATION AND ITS EFFECTS
Berkeley's core enterprise/financial software, FUND$, was implemented twenty-five years ago. It lacks the data analysis, security, and specialized line-of-business functionality of modern software. The continued use of the software is costing significant hours of employee time, though it has not been quantified. We found in our audits that software deficiencies contributed to fraud risk, inefficiencies, and barriers to performance monitoring. In responding to our audits, management has demonstrated that fraud risks we identified can be reduced only by labor intensive manual work-arounds.

The FUND$ payroll/personnel system is inefficient and error-prone, with paper-based timecards and paper-based employee personnel transactions. Employees still enter time on paper time cards routed to supervisors for signature, to payroll clerks for time entry, and then to Payroll Audit for quality control. Pieces of paper still move through three different departments to complete a transaction as simple as an employee address change.

The City Auditor's Office, in addition to issuing performance audits of City programs, has responsibility for centralized functions of the decentralized payroll system. Over the past several years, we have set aside salary savings from the Performance Audit division to fund transition to an electronic time and attendance system. Savings were available because of our continued difficulty in timely recruitment of qualified performance auditors, and resulted in issuance of fewer audits and reduced nonaudit services such as training and consulting. As explained in tonight's budget update from the City Manager, these savings have been moved to a special account for the replacement of FUND$. Since it would be more efficient to replace the entire payroll/personnel system than to modify it, this funding falls far short of the anticipated costs.

The City recently funded a contract through the Government Finance Officers Association (GFOA) to identify steps to replace FUND$, and to update the 2010 cost projections. Although Council voted to set aside $500,000 in 2015 and in any future year that that Transfer Tax revenue exceeds projections, costs to modernize City software are still substantially underfunded.

BACKGROUND
The City purchased its core enterprise software system, nicknamed FUND$ (Financial Utility Network Data System), in 1990. As far back as 1994, efforts were underway to replace its paper-based timekeeping system with an online system, and in 2001 a management committee was formed to explore replacing the entire FUND$ system. In 2010, Council requested an update on efforts to replace FUND$. An interim strategy of using middleware, a data warehouse, and enterprise reporting was implemented and reported to Council on June 1, 2010. That report is included in the 2014 Council item from Information Technology referenced above. In line with that strategy, some FUND$ modules are currently being replaced.

For several years, Council budget policies have included a provision that one time revenues are to be used only for one-time expenses. In 2015, the Council approved a policy of setting aside $500,000 for FUND$ replacement every year that the Transfer Tax exceeds budgeted amounts; $500,000 was set aside in 2015. Excess Transfer Tax funds are considered one-time revenue, and a particularly volatile type of revenue. The set-aside for FUND$ will not continue unless Transfer Tax revenues maintain their recent increases. Even at the planned rate of $500,000 annually, funding appears insufficient for the timely implementation of a new system.

ENVIRONMENTAL SUSTAINABILITY
Moving to a modern, electronic payroll/pension system will support the City's sustainability goals by eliminating the use of a paper-based timecard system and eliminate costs for paper and printing needs.

POSSIBLE FUTURE ACTION
Our upcoming audit of the City's current reserves policy is likely to include recommendations for Council action.

Council will need to take action to address the underfunded and unfunded needs of the City. These include employee benefit and pension liabilities and capital asset and infrastructure needs, including FUND$ replacement. This will involve setting priorities for which programs to fund, and at what level, and how to budget for the long term sustainability of services and assets.

FISCAL IMPACTS OF POSSIBLE FUTURE ACTION
Improving the City's infrastructure and its fiscal policies would be less resource-intensive than delaying action, because of current inefficiencies and because of the increased cost to repair assets, such as streets, as they continue to deteriorate. Action now could reduce future liabilities and protect City services for future generations.

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[1] Tough Budget Decisions Four Years Later: Building Analytical Capacity for Wiser Decision Making (July 2014): http://www.cityofberkeley.info/Clerk/City_Council/2014/07_Jul/Documents/2014-07-08_Item_57_Tough_Budget_Decisions.aspx

[2] Employee Benefits: Tough Decisions Ahead (November 2010): http://www.cityofberkeley.info/uploadedFiles/Auditor/Level_3_-_General/2010-11-16_Item_13_Employee_Benefits_Tough_Decisions_Ahead-Auditor(1).pdf

[3] Projections of Future Liabilities (February 2015): http://www.ci.berkeley.ca.us/Clerk/City_Council/2015/02_Feb/Documents/2015-02-24_WS_Item_01_Projections_of_Future.aspx

[4] Discussion and Direction Regarding Potential Ballot Measures for the November 6, 2012 General Municipal Election (February 2012): http://www.cityofberkeley.info/uploadedFiles/Clerk/Level_3_-_City_Council/2012/02Feb/2012-02-28_Item_31_Discussion_and_Direction_Regarding.pdf

[5] FUND$ Status Report (March 2014): http://www.cityofberkeley.info/Clerk/City_Council/2014/03_Mar/Documents/2014-03-25_Item_34_FUND$_Status_Report.aspx