



**INTERNAL CONTROL IMPACT OF
STAFF REDUCTIONS**

SPECIAL AUDIT

JULY 1, 2009 THROUGH JANUARY 31, 2010

**CITY OF CHESAPEAKE, VIRGINIA
AUDIT SERVICES DEPARTMENT**

March 4, 2010

The Honorable Alan P. Krasnoff and
Members of the City Council
City of Chesapeake
City Hall – 6th Floor
Chesapeake, Virginia 23328

Dear Mayor Krasnoff and Members of the City Council:

We have completed a special audit on the Internal Control Impacts of Staff Reductions for the period July 1, 2009 to January 31, 2010. The purpose of this audit was to evaluate the effect of staffing reductions on internal controls and departmental operations. This audit was requested by the City Manager's Office and also was recommended by the City's external auditors.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

In May 2009, the City Council voted to eliminate 37 largely vacant positions as part of its Fiscal Year 2010 Operating Budget (FY 2010 budget) approval process. When the elimination of these positions and a City-sponsored voluntary retirement incentive program did not provide sufficient savings to balance the FY 2010 budget, the City instituted a Reduction-in-Force (RIF), laying-off 23 employees in filled positions as part of the process. The retirement incentive program allowed 65 employees to retire, which then resulted in 18 full-time, 15 part-time, and 6 Encore positions being deleted or reduced in hours or classification. Those positions vacated with the retirement incentive program will be evaluated during subsequent departmental performance audits.

In November 2009, the City Manager's Office requested that Audit Services review the internal control impacts associated with the positions eliminated during the operating budget approval process as well as the positions associated with the RIF. The City's external audit firm, Cherry, Bekaert & Holland, also raised the issue of the internal control impacts during its year-end presentation to the City Council's Audit Committee. The Audit Committee concurred with this request, and Audit Services initiated this audit in December 2009.

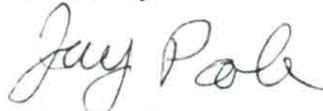
To conduct this audit, we utilized the FY 2010 budget document's listing of positions eliminated as well as a listing from Human Resources of staff positions that were eliminated in the October 2009 RIF. We then surveyed City departments that had lost positions and evaluated the internal control and service delivery impacts of the losses.

Based upon our review we noted that, although there were several positions whose eliminations did not have adverse internal control or service delivery impacts, there were many other positions whose elimination created these adverse impacts. Generally we found that the services provided were still provided, but certain non-emergency services were not carried as in as timely a manner as before. We also found that internal controls as defined by (1) Effectiveness and efficiency of operations; (2) Reliability of financial reporting and (3) Compliance with applicable laws and regulations were being met, but with increased risk, particularly as it related to separation of functions.

We noted significant adverse internal control impacts in Finance, General Services, Information Technology, Parks and Recreation, Police, Public Utilities, and the Treasurer's Office. We also noted significant service delivery impacts in Development and Permits, Health, Human Resources, Libraries and Research Services, Parks and Recreation, Planning, Public Utilities, and the Sheriff's Office. To address this situation, we recommended that the City develop an Administrative Regulation that provided guidance to departments for assessment of internal controls, operational controls, and service impacts whenever reductions occurred.

This report, in draft was provided to the City Manager's Office for review and response, and their comments have been considered in the preparation of this report. These comments have been included in the managerial summary, the Audit Report, and Appendix A. All of the City departments we worked with were very helpful throughout the audit, and we appreciated their courtesy and cooperation on this assignment.

Sincerely,



Jay Poole
City Auditor
City of Chesapeake, Virginia

C: William E. Harrell, City Manager
Betty J. Meyer, PhD, Deputy City Manager – Finance/Administration

Managerial Summary

A. Introduction, Background, and Scope

We have completed a special audit on the Control Impacts of Staffing Reductions for the period July 1, 2009 to January 31, 2010. The purpose of this audit was to evaluate the effect of staffing reductions on internal controls and departmental operations. This audit was requested by the City Manager's Office and also was recommended by the City's external auditors.

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Major Observations and Conclusions

Based upon our review we noted that, although there were several positions whose eliminations did not have adverse internal control or service delivery impacts, there were many other positions whose elimination created these adverse impacts. Generally we found that the services provided were still provided, but certain non-emergency services were not carried as in as timely a manner as before. We also found that internal controls as defined by (1) Effectiveness and efficiency of operations; (2) Reliability of financial reporting and (3) Compliance with applicable laws and regulations were being met, but with increased risk, particularly as it related to separation of functions.

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B. Background

In response to a budgetary shortfall in local revenues that was initially projected to be as large as \$30 million, the City Manager proposed eliminating 44 positions in the FY 2010 Operating Budget. Most of these positions were vacant although, in seven instances, the budget proposed changing filled full-time positions to part-time status.

When the position eliminations and a voluntary retirement incentive program did not provide cost savings sufficient to balance the FY 2010 budget, the City initiated a RIF. The City Manager's letter to all City employees (dated October 30, 2009) identified Group 1 employees as outlined in Administrative Regulation 2.17 as subject to the Reduction-in-Force (RIF). Those were part-time and full-time employees whose last overall performance evaluation had a rating of "Improvement Required" or "Unsatisfactory Performance."

C. Administrative and Operational Issues

Based upon our review we noted that, although there were several positions whose eliminations did not have adverse internal control or service delivery impacts, there were many other positions whose elimination created these adverse impacts. Generally, we

found that the services provided were still provided, but certain non-emergency services were not carried out in as timely a manner as before. We also found that internal controls as defined by (1) Effectiveness and efficiency of operations; (2) Reliability of financial reporting and (3) Compliance with applicable laws and regulations were being met, but with increased risk, particularly as it related to separation of functions.

Finding – The City's internal control structure and service delivery were being adversely impacted by the elimination of positions occurring as a result of the budget process and the RIF.

Recommendation – To minimize the effects of staff reductions and vacancies, the City should implement guidance, preferably in the form of an Administrative Regulation, for assessment of internal controls and operational service impacts. Additionally, the City should take steps to ensure that controls in areas impacted by staffing reductions are adjusted to compensate for the positions lost.

Response: We have reviewed the subject draft report. Our response is three-fold as follows:

As I shared with you last week, the report does not account for reductions related to the Voluntary Retirement Incentive Program. Human Resources reviewed the report and provided additional information and comments. These were provided to you last week via e-mail.

The report has been reviewed by City Manager's staff and we intend to work with departments to address areas of concern. Some of the stated impacts of reductions were not information which was shared with management when budget decisions were made in developing the FY 2009-10 Operating Budget. However, we believe some of the impact can be addressed through sharing of resources and some changes in operational practices. Other impacts are simply the unavoidable consequence of reduced resources. We anticipate additional and more significant impacts on services in FY 2010-11.

We have contacted the Government Finance Officers Association to seek models for administrative guidance for ensuring maintenance of internal controls in an environment of shrinking personnel resources. If you or your staff is aware of such a model, we would welcome such information as we wish to meet your recommendation of providing such guidance to departments as quickly as possible. Developing such guidance "from scratch" will require time, given resource constraints. We will share the guidance we develop with you as soon as it can be developed.

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SPECIAL AUDIT

July 1, 2009 TO January 31, 2010

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Scope and Methodology

To conduct this audit, we utilized the FY 2010 budget document's listing of positions eliminated. This document identified 37 positions, most of which were vacant, although there were seven positions that were transferred from full-time to part-time status. We also obtained a listing from Human Resources of staff positions that were eliminated in the October 2009 RIF. All of the employees eliminated in the RIF had been identified in recent evaluations as either "Unsatisfactory" or "Needs Improvement".

In addition, we surveyed 16 City departments that had lost positions. The survey asked for descriptions of work performed, how job responsibilities were absorbed, the effect of the lost positions on operations, and the potential risks that arose due to the lost position. After reviewing the surveys, we evaluated the internal control and service delivery impacts of the losses.

B. Background

In response to a budgetary shortfall in local revenues that was initially projected to be as large as \$30 million, the City Manager proposed eliminating 44 positions in the FY 2010 Operating Budget. Most of these positions were vacant although, in seven instances, the budget proposed changing filled full-time positions to part-time status.

The City's Approved Operating Budget for Fiscal Year 2009-2010 identified the following 37 positions for elimination and seven for conversion to part-time:

Exhibit 1 Positions Eliminated from FY 2010 Budget	
Budget	Office Coordinator to <i>PART TIME</i>
Circuit Court Clerk	Deputy Clerk of Circuit Court II to <i>PART TIME</i> Deputy Clerk of Circuit Court IV to <i>PART TIME</i>
City Manager	Assistant to City Manager
City Treasurer	Account Technician I Customer Service Clerk II Data Control Technician I
Commonwealth Attorney	Assistant Commonwealth Attorney to <i>PART TIME</i> Paralegal to <i>PART TIME</i>
Conference Center	Facility Maintenance Tech II to <i>PART TIME</i>
Finance	Accountant III Finance Operation Director/Assistant Director
General Services	Housekeeper I Engineer IV Mechanic V
Human Resources	Office Assistant II to <i>PART TIME</i> Human Resources Specialist II
Human Services	Social Worker II
Information Technology	System Analyst I
Libraries and Research Services	Library Assistant II Librarian I Librarian III
Parks and Recreation	Accountant II Events Logistic Coordinator
Planning	Office Specialist I Senior Planner
Police	(4) Police Resource Officer
Public Communications	Office Assistant I

Exhibit 1 Positions Eliminated from FY 2010 Budget	
Public Procurement	Procurement Specialist II Assistant Buyer
Public Works	Customer Support Technician I (2) Construction Inspector II Engineer II Engineering CADD Technician II Motor Equipment Operator I Bridge Administrator Motor Equipment Operator II Motor Equipment Operator III
Real Estate Assessor	GIS Technician
Sheriff	Client Technology Analyst II

When the position eliminations and a voluntary retirement incentive program did not provide cost savings sufficient to balance the FY 2010 budget, the City initiated a RIF. The City Manager's letter to all City employees (dated October 30, 2009) identified Group 1 employees as outlined in Administrative Regulation 2.17 as subject to the Reduction-in-Force (RIF). Those were part-time and full-time employees whose last overall performance evaluation had a rating of "Improvement Required" or "Unsatisfactory Performance."

On October 31, 2009 the City eliminated the following positions as a result of this RIF:

Exhibit 2 October 2009 Reduction-in-Force positions	
City Treasurer	Customer Service Clerk II
Community Services Board	(2) Clinician II
Development and Permits	Construction Inspector II Construction Inspector Supervisor Chief Code Compliance Inspector Mechanical Inspector II
Economic Development	Substitute/Seasonal Banquet Server
Health Department	Administrative Office Specialist II
Human Services	Children's Counselor I
Information Technology	Application Development Analyst II
Libraries and Research Services	Librarian II
Parks and Recreation	Recreation Leader Groundskeeper
Police	Office Assistant II
Public Utilities	Water Treatment Plant Chief Operator Laborer/Operator Motor Equipment Operator II
Public Works	(4) Laborer Motor Equipment Operator I

C. Administrative and Operational Issues

Based upon our review we noted that, although there were several positions whose eliminations did not have adverse internal control or service delivery impacts, there were many other positions whose elimination created these adverse impacts. Generally, we found that the services provided were still provided, but certain non-emergency services were not carried out in as timely a manner as before. We also found that internal controls as defined by (1) Effectiveness and efficiency of operations; (2) Reliability of financial reporting and (3) Compliance with applicable laws and regulations were being met, but with increased risk, particularly as it related to separation of functions.

Finding: The City's internal control structure and service delivery were being adversely impacted by the elimination of positions occurring as a result of the budget process and the RIF.

As a local government entity, the City was subject to Office of Management and Budget Circular A-133 (Circular), which required it to maintain effective control over financial reporting. According to the Circular "Internal Control means a process, effected by an entity's management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: (1) Effectiveness and efficiency of operations; (2) Reliability of financial reporting; and (3) Compliance with applicable laws and regulations.

In reviewing the control impacts, we noted that there were several positions, most notably in Public Works, where departmental management indicated that there were no adverse impacts from the loss of the positions. In Public Works, this situation may have resulted from the fact that many of the positions lost had either been vacant for extended periods of time, such as the Engineering positions or were lower level positions, such as the laborer positions, where the incumbents had performance issues.

In most cases, however, our surveys identified adverse impacts related to both internal controls and service delivery. We reviewed the potential internal control impacts of these eliminated positions and noted the following:

- Finance – The Assistant Director position had been responsible for oversight of the department's operational functions, including accounting, accounts payable processing and payroll. When this position was eliminated, the Finance Director assumed responsibility for the payroll function and assigned the oversight function for the accounting and accounts payable functions to the City's Controller/Accounting Manager. While the Controller/Accounting Manager was generally not responsible for initial preparation of transaction documents (the task was assigned to staff who reported to the Controller/Accounting Manager, so separation of duties could be maintained), the control process became less independent and thus less effective than it would be if someone outside of the accounting process, such as an assistant director, still had oversight authority over those functions. Also, the consolidation of responsibilities created by the loss of both

this position and an Accountant III Debt Analyst position increased the possibility for errors in important City financial documents, such as Bond Resolution documents or the City's Comprehensive Annual Financial Report.

- General Services – The Engineer IV position acted as Project Manager for assigned Capital Improvement Budget (CIB) and maintenance/repair projects that typically ranged from \$20,000 up to several million dollars, but on rare occasions approached \$50 million or higher. As Project Manager, the Engineer IV was responsible for reviewing the progress of CIB projects and authorizing project payments to the contractors. The Engineer IV position also managed the CIB development and submission process; work with other City departments and agencies to develop project descriptions, concepts, and estimates. The loss of this position has shifted this dedicated work to the Facilities Manager and the two Facility Management Division's Project Managers.
- Information Technology – The Application Development Analyst II position directly supported various critical applications that were used by City departments to provide customer services efficiently on a daily basis. These software applications were in constant need of maintenance and support on a daily and weekly basis to meet changes in customer business processes, City ordinances, and State regulation requirements. There was a high degree of risk that software coding changes could be entered without the level of review previously conducted. Risks included the possibility of software coding errors causing erroneous calculations related to accounts receivable payments for services, permits, or taxes, in addition to delayed response to internal/external customer service and delayed delivery of services. Also, vendor applications required upgrades to be performed in order to remain on vendor maintenance. If upgrades were not performed, then these systems had the possibility of failure with no possibility of vendor support to correct the problem. Without support on these applications, any operational problems, product upgrades, or application functionality would not be able to have been corrected. City employees would have to revert to entering data manually and filling out hard copy reports.
- Parks and Recreation – The Accountant II prepared most of the financial or accounting transactions in the department that were initiated or processed. As such, this position was one of the most critical positions in the Administrative Division. This position prepared all year-end reconciliations, journal entries, and year-end financial statements and documents required by both the Finance Department and the external audit firm. The position also prepared all purchase orders. Without the position reconciliations, including those for grants, open space funds, and rental deposits could not be prepared on a timely basis. Finance had to wait on reconciliations that Parks and Recreation could not get to due to more critical tasks that had to be performed (such as deposits and implementation of new software) on a daily basis. Other service impacts included less timely payments to vendors, additional corrections to purchasing and expenditure related paperwork and more frequent phone calls from vendors inquiring as to payment status.

- Police – The Office Assistant II served as one of three employees responsible for the settlement and reconciliation of the daily cash sheet transactions for Animal Control’s Animal Shelter. The RIF of the Office Assistant II assigned to Animal Control’s animal shelter contributed to the decision to cut the hours of shelter operation from 47 hours per week to 32 hours. The remaining 1 full-time equivalent (FTE) and 1 part-time equivalent (PTE) office assistants had to absorb the duties of the vacant position. As a result, Animal Control was behind in exposure reports (bites and rabies control) and responses, customer service requests, compilation of statistics and payment of bills. There was also additional use of overtime for the remaining office assistants to complete those items. As a result, both separation of duties and conduct of normal operations were adversely impacted.
- Public Utilities – There was one Water Treatment Plant Chief Operator at each of the two treatment facilities prior to the RIF. The Chief Operator was the principal liaison and coordinator among the core groups of (1) the laboratory, (2) maintenance, and (3) operations. As required by Virginia Department of Health, a Class I certified waterworks operator must be available on a continuous basis to assist with plant operations and provide input for problems related to treatment and other issues. After the RIF, there was only one Water Treatment Plant Chief Operator providing the required continuous coverage for both treatment facilities that were operated around the clock using shift-work personnel. The Chief Operator had also spent a significant amount of time prioritizing purchasing needs, obtaining bids, reviewing bids, and completing purchase requisitions at the two separate treatment plants. Thus, all phases of plant operation were adversely impacted.
- Treasurer’s Office – The Account Technician I position handled reconciliation of posting errors, filled in at the counter during vacations, responded to taxpayer inquiries, performed maintenance on the tax data base, assigned account numbers to real estate parcels, searched for missing social security numbers, served as a backup for reconciliation of the daily cash sheet transactions, issued refund checks, verified that refunds were due before issuing refund checks, and other tasks as assigned. When this position was eliminated, exempted employees tried to assist in non-office hours within the limitations of their assigned workload. The key internal control was the reduction of availability of trained personnel to conduct independent reconciliation. The reduction adversely impacted the separation of duties within the Treasurer’s Office.

In addition there were a number of lost positions that, while they did not impact internal controls were likely to have adverse impacts on service delivery.

- Development and Permits - Because the Mechanical Inspector II was the only inspector with certification to perform State mandated acceptance inspections on elevators and escalators, the City had to use third party inspectors for that purpose. The loss of the Chief Code Compliance Inspector resulted in the remaining code inspectors rotating assignment to front counter work, which caused a reduction in

the resolution of zoning violations. There was also an increased risk of mistakes when issuing permits due to inconsistent zoning reviews, and decrease assurance of uniform application of zoning ordinances.

- Health – The elimination of the Administrative Office Specialist II reduced the timeliness of filing required reports, scheduling of appointments, and efficiency of the Occupational Health Services Division. There was an increased risk of delays in preparing duty status clearance forms, delays in correspondence to and from medical specialty offices, and delays in appointments. Phones were often left unanswered while the three remaining staff (one Nurse Practitioner (NP), one Registered Nurse (RN), and one Licensed Practical Nurse (LPN)) were attending to patients in the office. Sorting, filing and data entry were slowed resulting in delayed response time by the nurses to abnormal patient findings that required immediate attention.
- Human Resources – The elimination of the Human Resources Specialist II position placed the City in the position of consistently requesting the Equal Employment Opportunity Commission for time extensions in order to thoroughly investigate complaints of discrimination and prepare a thorough response.
- Libraries and Research Services – With the loss of positions of Librarian II and Librarian III, exempt employees were attempting to absorb those duties along with their existing duties, which resulted in extending their work weeks to working a minimum of 45 to 50 hours.
- Parks and Recreation - The loss of the Groundskeeper position meant that other workers had increased workloads and required overtime that was compensated with overtime leave instead of overtime pay.
- Planning Department - The loss of the Senior Planner affected the City's ability to capitalize on opportunities that presented themselves to the City. For example, opportunities to receive funding through various grant programs with short turnaround times were foregone (e.g. stimulus funding opportunities). Also, redevelopment initiatives for the Great Bridge waterfront had to be postponed, which ultimately reduced economic development opportunities for the City. The Office Specialist I Position was responsible for compiling and copying Planning Commission and City Council packages, which were highly visible documents. Existing staff had to absorb this position's responsibilities, which led to the risk of mistakes and/or delays in publication in the Planning Commission not having sufficient time to review background information. Also, there was a lack of support staff to process applications which could have increased review time frames by at least 30 days.
- Public Utilities - The lost positions such as Motor Equipment Operator and Laborer/Operator had contributed to increased workload on the remaining staff. In addition, the department exceeded its budgeted overtime for FY 2010.

- Sheriff – The loss of the Client Technology Analyst II created a substantial risk to officer safety when critical information on a subject would not be available for officers to see due to computer outages.

As previously noted, these position reductions occurred as a result of the City efforts to balance the FY 2010 Operating Budget. In many cases, positions which had been vacant were eliminated. Also, the City underwent the RIF because the savings generated from elimination of these positions and the retirement incentive program did not provide sufficient savings to balance the operating budget. However, unless the City takes steps to make control adjustments for these position losses, they could undermine the City's underlying internal control structure, potentially adversely impacting delivery of services as well as operational, programmatic and financial reporting.

Recommendation: To minimize the effects of staff reductions and vacancies, the City should implement guidance, preferably in the form of an Administrative Regulation, for assessment of internal controls and operational service impacts. Additionally, the City should take steps to ensure that controls in areas impacted by staffing reductions are adjusted to compensate for the positions lost.

Since the City is unlikely to acquire resources to restore the lost positions in the foreseeable future, the City should assess the internal control impacts of staffing reductions whenever there are vacant positions eliminated or a RIF. Conducting this assessment will better position the City to address internal control and service delivery issues that arise when these staffing reductions occur, and should help to mitigate the adverse impacts of those reductions. The results of the assessment should be documented in writing so that they can be evaluated by the external auditors or acted upon by City management as necessary.

In addition, the City may wish to consider the following items in developing guidance for these controls and service assessments:

- Financial Control Impact – Will the position reductions impact items such as initial recording on reconciliation of revenue, timeliness of deposit, initiation and processing of expenditure or payroll transactions, approval of transactions, or otherwise impact separation of duties? How will overall and specific financial risks be addressed?
- Operational Control Impacts – How will position reduction impact departmental operating practices such as initial response to service requests, acquisition and usage of departmental resources, overall and individual workloads, and execution documentation, and reporting of work completed? How will the reductions impact contingency plans? How will overall and specific operational risks be addressed?
- Customer Service Impacts – How will the department continue to meet customer needs? How will customer response times be impacted? How will overall and specific customer service risks be addressed?

Response: We have reviewed the subject draft report. Our response is three-fold as follows:

As I shared with you last week, the report does not account for reductions related to the Voluntary Retirement Incentive Program. Human Resources reviewed the report and provided additional information and comments. These were provided to you last week via e-mail.

The report has been reviewed by City Manager's staff and we intend to work with departments to address areas of concern. Some of the stated impacts of reductions were not information which was shared with management when budget decisions were made in developing the FY 2009-10 Operating Budget. However, we believe some of the impact can be addressed through sharing of resources and some changes in operational practices. Other impacts are simply the unavoidable consequence of reduced resources. We anticipate additional and more significant impacts on services in FY 2010-11.

We have contacted the Government Finance Officers Association to seek models for administrative guidance for ensuring maintenance of internal controls in an environment of shrinking personnel resources. If you or your staff is aware of such a model, we would welcome such information as we wish to meet your recommendation of providing such guidance to departments as quickly as possible. Developing such guidance "from scratch" will require time, given resource constraints. We will share the guidance we develop with you as soon as it can be developed.

APPENDIX A

RESPONSE FROM CITY MANAGER'S OFFICE OFFICIALS

Office of the City Manager
Post Office Box 15225
Chesapeake, Virginia 23328-5225
Office: (757) 382-6166
Fax: (757) 382-6507
TDD: (757) 382-8214

MEMORANDUM

TO: Jay Poole, City Auditor

FROM: Betty Jean Meyer, Ph.D., Deputy City Manager *BJMeyer*

DATE: March 2, 2010

RE: **Response to Audit on Control Impacts of Staffing Reductions**

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If there are further questions or concerns, please let us know.

/bjm

c: William E. Harrell, City Manager