

Office of City Auditor



Seattle City Light Salvage Unit
Fraud Risk Audit
Final Report

June 6, 2014

Project Team: Francis and Company, PLLC
Marc Stepper, Office of City Auditor
Robin Howe, Office of City Auditor

City Auditor: David G. Jones



Our Mission:

To help the City of Seattle achieve honest, efficient management and full accountability throughout City government. We serve the public interest by providing the City Council, Mayor and City department heads with accurate information, unbiased analysis, and objective recommendations on how best to use public resources in support of the well-being of Seattle residents.

Background:

Seattle voters established our office by a 1991 amendment to the City Charter. The office is an independent department within the legislative branch of City government. The City Auditor reports to the City Council and has a four-year term to ensure her/his independence in deciding what work the office should perform and reporting the results of this work. The Office of City Auditor conducts performance audits and non-audit projects covering City of Seattle programs, departments, grantees, and contracts. The City Auditor's goal is to ensure that the City of Seattle is run as effectively and efficiently as possible in compliance with applicable laws and regulations.

How We Ensure Quality:

The office's work is performed in accordance with the Government Auditing Standards issued by the Comptroller General of the United States. These standards provide guidelines for audit planning, fieldwork, quality control systems, staff training, and reporting of results. In addition, the standards require that external auditors periodically review our office's policies, procedures, and activities to ensure that we adhere to these professional standards.

An equal opportunity-affirmative action employer
Street Address: 700 5th Avenue, Suite 2410, Seattle, WA
Mailing address: PO Box 94729, Seattle, Washington 98124-4729
Phone: (206) 233-3801
Email: davidg.jones@seattle.gov
Website: seattle.gov/cityauditor

City of Seattle
Office of City Auditor



June 6, 2014

City of Seattle
Seattle, Washington 98104

Dear City Councilmembers:

Attached is our report, *Seattle City Light Salvage Unit, Fraud Risk Audit*. Our office prepared this report based on the work performed by the firm Francis and Company. We contracted with this firm to respond to your request for our office hire and oversee an outside firm's review of a high risk secondary revenue stream¹ at Seattle City Light (SCL). You made this request because of an alleged employee theft of over \$1 million of customer payments from a secondary revenue stream at Seattle Public Utilities (SPU). You wanted to ensure that appropriate controls were also in place over the secondary revenue streams at SCL, because these types of revenues have generally received less attention and scrutiny than the two utilities' primary revenue streams.

It is important to note that after the \$1 million fraud occurred at SPU but before the Francis and Company work began, SCL's external auditor, Baker Tilly, at the request of SCL management, performed procedures related to cash handling controls and fraud risks for SCL's secondary revenue streams. SCL requested Baker Tilly's work because of the potential risks exposed by the fraud at SPU. We found Baker Tilly's report² to be informative, and it helped us select the SCL secondary revenue stream we wanted an outside firm to review. In addition to using the Baker Tilly report, we also conducted our own preliminary interviews with various SCL personnel to help us determine which SCL secondary revenue streams appeared to have the highest risks. Based on the information we collected, we hired the firm Francis and Company to perform procedures relating to the fraud risks for the items handled by SCL's Salvage Unit.

Francis and Company performed an agreed-upon procedures engagement to assist our office with a fraud risk audit of Seattle City Light's Salvage Unit. The objectives of the procedures were to:

- 1) Establish, through testing of transactions, whether (a) past surplus sales were made in accordance with established policies and procedures; (b) sales were appropriately priced; (c) receipts were deposited in a timely manner, and (d) any assets were misappropriated.
- 2) Identify any weaknesses in the current internal control structure and make recommendations for improvement.

¹ A secondary revenue stream is any source of revenue for Seattle City Light other than the primary revenue streams derived from selling electricity to retail and wholesale customers.

² Agreed-Upon-Procedures engagement for SCL's Cash Handling Controls, published April 20, 2012.

Our office performed some field work for this audit in addition to the work performed by Francis and Company.

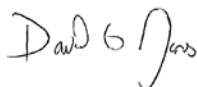
On April 24, 2013, after Francis and Company completed their fieldwork for this audit, SCL experienced a theft of copper wire from the Salvage Unit with an estimated value of \$114,000. As a result, we expanded the audit's scope to include this incident to determine what policies and procedures should have been followed to prevent the theft, and to recommend any improvements to help ensure this type of incident will not reoccur. We included a recommendation to address this incident in our report³.

SCL's action plans to address the findings identified during the audit are included in this report. The Department of Finance and Administrative Services (FAS) also plays a role in the sale of surplus materials at SCL, and their action plans are included for findings that involve FAS. In accordance with our office's standard procedures, we will follow-up on the progress made by SCL and FAS on complying with the report's recommendations, and we will issue a separate report, at a future date, to the City Council and Mayor on the recommendations' implementation status.

We appreciated the cooperation of SCL and FAS personnel during the audit, and want to thank Francis and Company for their work.

Please contact me either by phone (206-233-1095) or email (davidg.jones@seattle.gov) if you have any questions or concerns about the report.

Sincerely,



David Jones
City Auditor

³ Recommendation 12.1

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SUMMARY OF RESULTS AND KEY FINDINGS

Francis and Company verified that all proceeds from SCL surplus sales they tested from the period 2007-2011 were accounted for. However, we have concerns about the Salvage Unit's ability to provide adequate safeguards over surplus yard assets. Accordingly, we made several recommendations to improve internal controls over the safeguarding of those assets.

The following are some key findings noted in the report. Each of the findings carries with it a risk of misappropriation of either surplus assets or customer payments. A complete list of findings and recommendations is found starting on page 13.

- Materials sent to the Salvage Unit without advance notice of their pending arrival could be misappropriated before delivery without detection (Finding 1.1).
- Returns of transmission and distribution wire to the Salvage Unit are not recorded in the Passport tool system until close to the time of sale, creating the opportunity for the misappropriation of unrecorded deliveries of wire (Finding 1.2).
- Customers purchasing items subject to a bid sale may take delivery of the materials without making the entire payment and without undergoing an appropriate credit background check. Further, resulting receivable balances are not recorded in the financial accounting system, placing such payment balances at risk for misappropriation (Finding 2.1).
- Security personnel at the Salvage Unit are not collecting sales documentation as required from all customers as they exit the surplus sales facility. Failure to inspect customer purchase documentation may result in the undetected theft of salvage materials (Finding 3.1).
- Maintaining physical control of surplus materials in conjunction with recording the same materials in the Passport tracking tool are incompatible duties. This condition presents an opportunity for intentional manipulation of recorded salvage material quantities to conceal their misappropriation. Adjustments to recorded material quantities in the Passport tool coded as issues rather than adjustments could conceal the misappropriation of materials. There may be surplus materials of value, either individually or in the aggregate, that are not tracked through the Passport tool that are at risk of misappropriation (Finding 5.1).
- The general ledger account used by SCL's Cashiering and Cost Accounting Units to record customer payments and surplus sales is not reconciled completely and timely. The absence of complete and timely account reconciliations of this account may result in the undetected misappropriation of customer payments (Finding 6.1).
- There is no independent reconciliation of supporting documentation to the sales invoice by SCL personnel outside the Salvage Unit. Deliberate attempts to exclude or misprice the materials may not be detected as a result (Finding 7.1).

- Duties regarding the collection of customer payments, maintaining the custody of SCL Salvage Unit assets, pricing, and invoicing are not adequately segregated for courtesy⁴ and contract⁵ sales, creating the opportunity for the misappropriation of surplus assets and customer payments (Finding 9.1).
- Policies and procedures that govern the activities over the Salvage Unit have not been updated since 1999, increasing the risk of non-compliance and may compromise currently designed controls (Finding 10.1).
- Written blanket authorization to sell a specified list of items through courtesy sales has not been provided by FAS to the Salvage Unit as required by policy. This condition creates the opportunity for the misappropriation of high dollar materials and customer payments (Finding 11.1).

We note that SCL has already taken steps to address several of these findings.

BACKGROUND

Seattle City Light (SCL) is responsible for providing electricity and related services to the greater Seattle area. To help achieve this purpose, SCL operates four service centers: North, South, Skagit and Boundary. Each of these service centers generates large quantities of surplus materials. The SCL Salvage Unit, located at the South Service Center, is primarily responsible for sorting and disposing of these surplus items.

Common items designated as surplus include wire (copper and aluminum), transformers, vehicles, office equipment, computers, lamps, electrical equipment, and tools. Various methods are employed to sell surplus materials. The sealed bid process is generally used to sell large quantities of transmission and distribution wire. For this process, the Department of Finance and Administrative Services (FAS) is involved in soliciting bids from vendors and in the selection of the successful bidders. Vehicles and large equipment items are sold by a third party through online auctions using services such as eBay. Transformers and transformer oil is sold using vendor contracts with negotiated prices. Other items, such as street lamps, poles, tools, and small equipment items are sold on a walk-in basis to the public. Some items, such as wire and certain transformers, are sold by weight. Electronic scales are located at the South Service Center, which are used to weigh items for sale purposes.

Materials and equipment brought to the South Service Center are either transferred from other service centers or delivered by SCL operations crews involved in maintenance and repair work, such as replacing distribution wire damaged in storms. Incoming materials are sorted and stored in designated locations. In some cases, materials can be refurbished and returned to stock at the stores warehouse, located near the salvage facility. Some items that have little or no value are discarded as junk.

⁴ Courtesy sales are defined by SCL as sales to the public of salvage materials in small quantities on a walk-in basis.

⁵ Contract sales generally involve the sale of surplus transformers, which are often high price items.

OBJECTIVES

We hired Francis and Company, PLLC to perform an agreed-upon procedures engagement to help our office with the audit of SCL's Salvage Unit. The primary objectives of the procedures were to:

- Establish, through testing of transactions, whether (a) past surplus sales were made in accordance with established policies and procedures; (b) sales were appropriately priced; (c) receipts were deposited in a timely manner, and (d) any assets were misappropriated.
- Identify any weaknesses in the current internal control structure and make recommendations for improvement.

SCOPE AND METHODOLOGY

Francis and Company included the following procedures to accomplish the audit objectives: (1) interviews of personnel and reviews of documentation to gain understanding of the sales, inventory, and treasury cycles related to surplus items handled by the SCL Salvage Unit; (2) testing a random sample of the SCL Salvage Unit's sales transactions from 2007 through 2011 to ensure sales were made in accordance with policies and procedures and customer payments were timely deposited into the treasury; (3) testing controls to determine if materials were leaving the South Service Center salvage facility with proper authorization; (4) testing of blanket sales transactions⁶ for appropriate pricing and supporting documentation; (5) review of inventory adjustments, management approvals, and accounting for salvage inventory. They also assessed current controls over Salvage Unit operations to determine if controls over the safeguarding of assets were effective.

Our office performed additional field work, which included testing 2012 and 2013 reconciliations to the balance sheet account where surplus sales and payments are recorded. We also performed sequential testing for completeness of invoice recording to the same balance sheet account. We conducted interviews with personnel from both SCL and FAS, and reviewed relevant policies and procedures from both departments. We subsequently expanded the audit scope to include an analysis of policies and procedures relating to the donation of Salvage Unit assets due to a theft that occurred at the Salvage Unit after the completion of field work by Francis and Company.

The testing and controls work for this audit was limited to salvage items processed by the South Service Center Salvage Unit and did not include the North, Skagit, or Boundary Service Centers.

⁶ Blanket sales transactions refer to sales made on contract, such as transformers.

The scope was further limited to materials disposed of through sealed bid, courtesy and contract sales.⁷

Compliance with Government Auditing Standards

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require 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.

PREVIOUS RELATED AUDITS

Baker Tilly, Seattle City Light's external auditor, noted in their 2012 financial statement audit "the Department does not currently have sufficient controls in place to ensure the effective operation of the payment receipt process."⁸ In their 2013 financial audit, no internal control deficiencies were noted.

FINDINGS AND RECOMMENDATIONS

Based on their agreed-upon procedures work, Francis and Company stated they verified that all proceeds from SCL surplus sales they tested for the period 2007-2011 were accounted for. However, we have concerns about the Salvage Unit's ability to provide adequate safeguards over surplus yard assets. Accordingly, we developed several recommendations to improve internal controls over the safeguarding of those assets.

The detailed findings of our audit and responses by SCL are listed in the following matrix and represent the work that both Francis and Company and our office performed.

⁷ According to Section 7.0 of the SCL policies and procedures that govern the sale of surplus materials and equipment (DPP 500 I-705), the materials not included in these disposal methods include mobile equipment, water heaters, office furniture and equipment, surplus computer equipment, hazardous materials, and transformers/oil not covered under contract sales. These materials are covered under a separate set of procedures.

⁸ Report on Internal Control Over the Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards.

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SEATTLE CITY LIGHT SALVAGE UNIT FRAUD RISK AUDIT FINDINGS AND RECOMMENDATIONS

SCL Introductory Management Comment:

Thank you for the opportunity to respond to the Fraud Risk Audit conducted by the City of Seattle Auditor and Francis and Company. Salvage represents a minor portion of City Lights utility operations and serves as an example of City Lights commitment to operate efficient and environmentally responsible business practices.

2013 Salvage Sales

Amount	Percentage	Type
\$ 2,288,246.01	82%	Bid
\$ 334,655.06	12%	Contract
\$ 180,998.81	6%	Sundry and Courtesy
<u>\$ 2,803,899.88</u>	<u>100%</u>	

In addition, in 2013 the salvage unit tracked about \$200,000 in savings by recycling and refurbishing used parts and equipment. Seattle City Light is committed to making sure our business practices have strong internal controls and we take very serious our responsibility to establish procedures that provide proper safeguarding of assets, such as scrap materials, and accounting for revenues from the sale of these assets. Therefore, we appreciate the independent review of salvage sales transactions to account for all the transactions and the test sample of transactions for the period of 2007-2011 that found no evidence of misappropriation, fraud or theft.

Despite no evidence of misappropriation the City Auditor report identified concerns and recommendations where they considered there to be a risk for potential misappropriation.

City Light Overall Response

- City Light agrees with six of the control and process improvements made in the areas of policies and procedures and controls around customer payments.
- For the remaining 5 recommendations, City Light Management does not believe that it is prudent to implement the recommendations. The process to inventorying salvage materials does not follow standard salvage industry practices. This was confirmed with six similarly sized electric utilities.

- Further and related, the costs to implement such controls outweigh the risk mitigation that would be provided. To implement the prescribed recommendations would nullify any proceeds coming from surplus salvage sales.
- In addition, City Light management strongly believes their mitigating controls significantly reduce the risk of misappropriation of assets.

In response to the audit City Light worked quickly and decisively to evaluate the concerns and recommendations and has already implemented changes or is in-progress to the following areas:

- City Light and the Department of Finance and Administrative Services (FAS) have revised the bid sale process that results in collecting almost all the bid sale money prior to customer pick-up of salvage material.
- For new customers, FAS will require an advance deposit.
- Salvage operations began using pre-numbered personal bills of sale for all salvage transactions.
- Security guards now obtain all personal bills of sale when customers and employees exit and delivery receipts for frequent vendors who make multiple trips.
- Account reconciliations are performed and reviewed monthly.
- New sponsorship guidelines for donating surplus items have been adopted and communicated.
- City Light management is updating the Salvage Department Policy & Procedure and expects to have this adopted and communicated by 6/30/14.
- FAS are developing new surplus guidelines to City Light and expect to have this ready by mid-2014.

Our detailed responses demonstrate that we take seriously the concerns presented by the audit. For the recommendations that identified a control weakness we implemented processes to strengthen those controls. However, in several instances the audit identified risk exposure of processes but specific audit procedures did not test or take into account other controls or processes that mitigate the risks exposure presented in this report. In those instances, City Light Management provides context in our response below and is not planning on any significant actions. City Light Internal Audit confirmed that City Light Management is following standard industry salvage practices by surveying other Large Public Power Council utilities and noted that they are following similar salvage processes for not tracking items as inventory, and recording as cash transactions as the value is not known until it's sold.

	FINDING	RISK	RECOMMENDATION
1.0 Accounting for Incoming Returns Tracking material returns	1.1 Materials destined for the Salvage Unit are returned from the field by SCL operations crews or from other SCL locations without advance notice to Salvage Unit personnel. Salvage Material Return forms (SMR's) are required by SCL policy to document material returns; however, they are not used to provide advance notice of pending returns to the Salvage Unit.	Without advance notice of salvage returns, materials such as copper wire are at high risk for misappropriation before their arrival at the Salvage Unit.	SCL should implement a tracking system to help ensure that materials considered to be of higher value and risk (e.g., copper wire and transformers) actually arrive at the Salvage Unit.

Recommendation 1.1

SCL Management Response:

City Light Management agrees that there is risk for misappropriation before items arrive at the South Service Center' however, we maintain that mitigating controls adequately address this risk. City Light Management will continue to assess if additional tracking procedures for high valued materials are warranted and make a final decision by 9/30/14.

The mitigating controls we rely on includes that all City Light work is supervised by Crew Chiefs and work is conducted by crews of no less than 2 employees per job. Any misappropriation would necessitate collusion among work crew members and circumvention of supervision. Additionally, the most valuable salvage items are heavy poly insulated wire and large transformers. These reels and large transformers weigh several thousand pounds and require specialized equipment and trucks to remove and transport. In addition, vendors who purchase salvage material need specialized equipment to strip the insulation from some of the most valuable wire sold by City Light.

	FINDING	RISK	RECOMMENDATION
Recording Incoming Shipments in Passport	1.2 Transmission and distribution wire removed from service is returned to the Salvage Unit by field crews or other SCL service center locations from time to time. The wire arrives at	(1) Wire that is not weighed and recorded upon arrival at the Salvage Unit could be misappropriated without detection.	(1) Wire returned to the Salvage Unit should be weighed each time a significant quantity is delivered, or as soon thereafter as operationally feasible, recorded on a weigh ticket, and recorded

	FINDING	RISK	RECOMMENDATION
Premature Destruction of Weigh Tickets	the Salvage Unit on spooled reels or as wire shorts, which is shorter length wire that is sorted and stored in metal bins once it arrives at the Salvage Unit. The wire is not weighed or recorded in the Passport tool tracking system upon arrival, but rather at or near the time of sale, which generally occurs once per month through the bid process. Metal bins used to contain the wire shorts are not sold and weighed until they are full. Any weigh tickets used to record the weight of incoming wire are destroyed.	(2) The premature destruction of weigh tickets eliminates an important audit trail for entries in the Passport tool in determining discrepancies between quantities recorded in Passport and physical quantities on hand. (3) Destruction of any previous weigh tickets at the time of sale is a violation of SCL document retention policies.	in the Passport tool. Wire accumulations should be periodically reconciled by personnel outside of the Salvage Unit, by comparing physical quantities on hand to quantities recorded in the Passport tool. All resulting discrepancies should be investigated. (2) All weigh tickets should be retained in accordance with SCL's document retention policies ⁹ .

Recommendation 1.2

SCL Management Response:

(1) City Light Management has evaluated the recommendation and determined that salvage unit is currently weighing salvage material when it is operationally feasible as recommended. Requiring salvage materials be sorted and weighed upon arrival at the South Service Center would increase personnel needs and necessitate extending work hours and paying overtime rates to both salvage and work crew personnel.

The current process and controls are noted below:

Salvage material arrives at the South Service Center 24 hours a day, 7 days a week from over 40 work crews that work 1 to 3 jobs a day. Two surveillance cameras monitor the salvage operations 24 hours a day, 7 days a week. One camera is fixed on activity of the sorting block and surrounding area and the other is a pan, tilt and zoom camera which is used by security to closely monitor any activities. This salvage material delivered from daily jobs and from the Skagit and Boundary Projects can experience large fluctuations in quantities resulting from several factors including major projects, emergency projects, and specific tasks on regular planned projects. Generally, salvage material is dropped off at the South Service Center at the end of shift. It's a primary duty of Salvage Warehouse workers is to ensure that delivered materials are examined

⁹ Public Records Retention Schedule & Destruction Authorization, Item 10.

and items with salvage value are held for sale, other items with remaining service value are reworked and returned to material stock and items with no sale or service value are disposed of as garbage.

Given the window of time and volume of material that can be delivered to the South Service Center it is not feasible to weigh wire and transformers upon arrival and those items are currently weighed when it is operationally feasible. City Light uses a bins system by which materials sold by weight (e.g., wire, wire shorts, brass pieces, and bare copper) are sorted into storage bins. When an individual bin is filled to capacity the bin is weighed by salvage personnel and relocated to a storage area to await a bulk bid sale. The bins may take several hours, days or weeks to accumulate enough material that warrants its removal from the sorting block. The sorting block and storage bins are located just outside the salvage office which is staffed 730AM-4PM Monday through Friday and the South Service Center is a gated facility with a security guard posted at the entrance.

(2) The Passport Inventory System is **not** used for salvage material and all sales are recorded as cash transactions by the FAS Treasury and City Light accounting. Salvage does have access to the Passport Salvage module (SLV) which is a tracking system only and is not used to generate financial transactions or interface with the General Ledger. The Passport SLV module is used to log material bin weights in order to monitor the accumulated amount of bid sale materials (e.g., wire, wire shorts, brass pieces, and bare copper) and report that amount to the Department of Finance and Administrative Services.

City Light salvage personnel ensure all individual bin weight tickets are logged in the Passport SLV and retained by the Senior Warehouse. The total weight is periodically reported to the Department of Finance and Administrative Services in order to estimate the total bulk material weight for a bid sale. A final weigh ticket is produced when a bid sale of the bulk material is completed in order to calculate the final sales price of the material. The sales documentation is reviewed by the Senior Warehouse and submitted to the General Warehouse Supervisor. The General Warehouse Supervisor reviews the documentation, logs the information in a salvage sales spreadsheet and forwards the spreadsheet to cost accounting for review and reconciliation to the general ledger. When the sales documentation is for a large bid sale the General Warehouse Supervisor also forwards the sales documentation to the Inventory Crew Chief in order to issue out the weights in the Passport SLV module used by salvage crews to estimate the bid sale.

Historically, only the final weight ticket of the bid sale was retained but beginning in 2014 the salvage unit has begun retaining all weight tickets used to estimate the bid sales. The Inventory crew chief reverses out the final weight with an issue entry into the SLV so there is independent party to monitor any differences between the interim and final weights.

Office of City Auditor Comment

We will examine the effectiveness of SCL's mitigating controls when we perform our annual follow-up.

	FINDING	RISK	RECOMMENDATION
<p>2.0</p> <p>Customer Payment Controls</p> <p>Credit Verification</p> <p>Receivables Recording</p>	<p>2.1</p> <p>Some surplus materials, such as wire, are sold by the Salvage Unit using the sealed bid process. Generally three payments are collected from successful bidders as follows: (a) the initial 10% deposit submitted with the bid, based on the estimated weight; (b) the balance of the payment based on the <i>estimated weight</i>; (c) the remaining “true-up” payment based on the difference between the estimated weight and the <i>actual weight</i> when delivered to the customer (materials may continue to be added to the order until the day the customer arrives to pick up the materials).</p> <p>According to the FAS Warehouse Manager, first-time customers are required to pay in full for the entire amount of the bid sale with a cashier’s check at the time the customer picks up the materials. However, for existing customers, the true-up payment is not made until <i>after</i> the materials are picked up and the customer has left the Salvage Unit. There is no credit information obtained on customers who are awarded the bid nor are written payment guarantees obtained.</p>	<p>(1) The lack of initial and periodic credit checks or the requirement for payment guarantees increases the risk of default on the true-up balance. Bid sales can be as high as several hundred thousand dollars with no limit on the portion attributable to the true-up.</p> <p>(2) Controls over the collection of receivable balances are compromised unless they are recorded in the financial accounting system and followed up in accordance with policies and procedures. Receivable balances that are unrecorded are at risk for misappropriation.</p>	<p>(1) SCL should either obtain supporting credit information or payment guarantees, or require that payments for bid sales be made in full before the customer takes delivery of the materials.</p> <p>(2) All balances not collected at the time of delivery to the customer should be recorded as a receivable in the financial accounting system and tracked to ensure timely and complete payment. Personal bills of sale should be issued for every delivery.</p>

	FINDING	RISK	RECOMMENDATION
	Further, there is no receivable created in the financial accounting system to reflect any unpaid balance of the bid sale.		

Recommendation 2.1

SCL Management Response:

The “true-up” weight for scrap bids represents a possible risk of financial loss. As mitigating controls for this risk, FAS is working with City Light to reduce this “true-up” payment by providing customers with actual weight of materials on the day bids are open. This results in the second payment collected from the winning bidder being closer to the actual weight and “true-up” balance is anticipated to be less than 1%. FAS will document weight information received from SCL. We will also require advance deposits from new customers, to further reduce the City’s risk. Please note, during the past 15 years, the Department of Finance and Administrative Services Warehousing Services has not experienced a default on payment of a “true-up” balance.

Due to the change in process, the magnitude of any uncollected remaining balances should essentially be eliminated so as City Light Management evaluated the recommendation to record any uncollected balances as a receivable, they and determined that our current process to account for the sales as cash transaction is appropriate and is also a standard salvage industry practice. City Light Management on 1/1/14 started recording all sales on a personal bill of sale. The personal bill of sale is not submitted to Cost Accounting until all the checks have been received. The mitigating controls is the act of accounting for all the personal bills of sales by the General Warehouse Supervisor, booking of the sales by Cost Accounting personnel and the reconciliation by General Accounting of the cash receipts to the personal bill of sales.

	FINDING	RISK	RECOMMENDATION
3.0 Security Inspection Controls Collection of Customer Invoice	3.1 Before exiting the South Service Center where the Salvage Unit is located, all customers who purchase surplus materials are required by SCL policies ¹⁰ to present a copy of a	(1) Failure to inspect customer purchase documentation upon exit from the South Service Center of employees or frequent vendors creates the opportunity for these two types of customers	(1) SCL management should enforce compliance with policies and procedures requiring Security to check sales documentation for all customers.

¹⁰ Department Policies and Procedures (DPP) 500 I-705, Section 7.2.2.6; SSC Security Officer Manual, Section 9.

	FINDING	RISK	RECOMMENDATION
Copies by Security	purchase invoice (either a personal bill of sale [PB] or a copy of the delivery receipt) to Security personnel, who are located in a small outdoor structure near the exit to the facility. SCL policy ¹¹ also requires that the SCL Warehouse Supervisor reconcile copies of the PBs received from Security and the South Service Center cashiers on a monthly basis to ensure all goods were checked by Security and paid for before leaving the facility.	to leave the Salvage Unit with misappropriated materials. (2) Failure to inspect all departing customer vehicles, including employees and vendors, for purchases of surplus materials could allow the theft of materials to go undetected. (3) If the reconciliation of purchase invoice copies from Security is not performed, the Warehouse Supervisor will not be alerted to the possible failure of Security to verify customer documentation.	(2) SCL management should require Security personnel to always perform a <i>visual inspection</i> of a customer's purchased materials before the customer exits the facility. (3) Warehouse personnel should perform the purchase invoice reconciliations as required.
Warehouse reconciliation of purchase invoice copies	Francis and Company (F&C) noted during their field work that most invoice copies from Security were not available for inspection during the period tested (2007 – 2011) because Security personnel hadn't collected and forwarded any invoice copies to the warehouse until 2010. In addition, when such invoice copies were being forwarded by Security to the warehouse, the required reconciliation of PB copies from Security and the cashiers was not being performed. After F&C's field work, SCL's Internal		

¹¹ DPP 500 I-705, Section 6.10.7.

	FINDING	RISK	RECOMMENDATION
	Audit group conducted their own review of the current practices at the South Service Center and stated they found that Security was collecting copies of the purchase invoice as required, except when the customer was an employee or frequent vendor.		

Recommendation 3.1

SCL Management Response:

(1) City Light Management takes their responsibility to manage security very serious and in response to this concern conducted an independent review of this matter. Our Independent review found security was following policies and procedures of collecting the personal bill of sale or a delivery receipt prior to customers leaving the facility. However, we noted some paperwork was not always being collected from an employee or regular / frequent vendor of City Light. City Light management and the City Light Security Manager will review guard orders and communicate to security City Light expectations to collect sales documentation and complete a visual inspection of purchased goods prior to customers and employees leaving the facility. The new procedures will be updated in Corporate Security's guard orders. (2 & 3) Currently, the General Warehouse Supervisor is performing purchase reconciliation by matching / reconciling personal bill of sales to copies of sales documents that are received from security guards to copies of the sales receipts they receive from the salvage yard.

	FINDING	RISK	RECOMMENDATION
<p>4.0 Sales and Delivery Receipt Tracking</p> <p>Unnumbered Delivery Receipts</p>	<p>4.1 F&C noted during field work that both numbered and unnumbered delivery receipts were in circulation. According to Salvage Unit personnel, <i>numbered</i> delivery receipts are used as invoices to record cash sales for walk-in customers, while <i>unnumbered</i> delivery receipts are used to track multiple deliveries to customers under a single purchase.</p>	<p>(1) Unnumbered delivery receipts cannot be sequentially controlled, and thus could be used as unrecorded customer invoices to conceal the misappropriation of surplus assets and customer payments.</p> <p>(2) Unnumbered delivery receipts do not provide adequate control over multiple deliveries to ensure that all deliveries of materials to</p>	<p>(1) Only sequentially numbered delivery receipts should be used to help ensure that all such receipts are accounted for, whether they are used to record a sales transaction or a delivery. Receipts used for deliveries should be traced to sales documents to ensure completeness of sales recording.</p> <p>(2) We recommend the Salvage Unit</p>

	FINDING	RISK	RECOMMENDATION
		customers are accounted for and billed.	use a separate numbering system for sales receipts vs. receipts used for deliveries to facilitate sequential tracking and control.

Recommendation 4.1

SCL Management Response:

City Light Management evaluated their current process and as of 1/1/2014 discontinued the use of delivery receipts for salvage sales and began using pre-numbered Personal Bills of Sale for all salvage transactions. City Light salvage will continue to use pre-numbered delivery receipts to track materials that require multiple pick-ups by vendors and reconcile those delivery receipts to the personal bill of sale. City Light salvage is in the process of updating policies and procedures to reflect the new processes.

	FINDING	RISK	RECOMMENDATION
5.0 Tracking and Reconciliation of Salvage Materials offered for Sale	5.1 The SLV module of the Passport inventory system (aka Passport tool) is used record quantities of wire sold through the bid process as well as transformers sold on contract. Physical quantities offered for sale are reconciled to recorded quantities in the Passport tool at time of sale. With respect to the use of the Passport tool, we note the following concerns: A. Salvage Unit personnel who have physical access to Salvage Unit materials also have access to record material quantities in the Passport tool.	(1) Maintaining physical control (custody) of surplus materials in conjunction with the ability to record the same materials in the Passport tool are incompatible duties. This condition presents an opportunity for intentional manipulation of recorded salvage material quantities in order to conceal their misappropriation. (2) Adjustments to material quantities that are coded as issues rather than adjustments could be used to conceal the misappropriation of materials. (3) There may be surplus materials of value, either individually or in	(1) The ability to record or adjust quantities in the Passport tool should be restricted to personnel who do not have physical control over Salvage Unit materials. (2) All adjustments to material quantities should be coded as adjustments and not as material issues or returns, even if they are to correct input errors. All quantity adjustments should be approved by management. (3) SCL should identify other salvage materials and equipment of value and track quantities for sale in the same manner as wire and transformers. Periodic

	FINDING	RISK	RECOMMENDATION
	<p>B. During testing, F&C noted that adjustments to quantities in the Passport tool were coded as issues (sales) rather than as adjustments.</p> <p>C. With the exception of wire and transformers, no other quantities of surplus materials and equipment are tracked using the Passport tool or any other system.</p>	<p>the aggregate, that are not tracked through the Passport tool that are at risk of misappropriation.</p>	<p>reconciliations between recorded and physical quantities on hand should be performed by personnel independent of the Salvage Unit, and discrepancies should be investigated.</p>

Recommendation 5.1

SCL Management Response:

City Light Management disagrees with recommendation (1). This recommendation addresses a segregation of duties risk that is present in an inventory environment. It is not a standard industry practice to track salvage materials as inventory. Establishing an inventory tracking process would require cumbersome and labor intensive work to acquire the needed information to input salvage material into the Passport System. The highest valued items wire and transformers are tracked and accounted for in the Passport SLV module and we have segregation of duties between who enters the salvage quantities and who removes them. For example, these transactions are booked as a return transaction to the SLV by salvage personnel and as an issue transaction by Inventory personnel when the wire is sold or the transformer is moved to the Transformer shop for refurbishment. We do not make any adjustments, if a significant error was made then it would be identified by the inventory person when they are issuing out the amounts and the warehouse supervisor would be notified. In addition, as noted in our 1.1 Management response we will continue to assess if additional tracking procedures for high valued materials are warranted and make a final decision by 9/30/14.

Office of City Auditor Comment

We want to emphasize that our recommendation concerns the *tracking* of materials and equipment of high value in the Passport tool and does not seek to establish a comprehensive inventory system for surplus yard assets. When reconciling recorded quantities in Passport to physical quantities on hand, segregating physical access to materials and equipment from the ability to record such quantities in Passport is essential if tracking is to be used as a control in safeguarding assets. In our opinion, SCL’s response does not adequately address this concern.

	FINDING	RISK	RECOMMENDATION
<p>6.0 Reconciliation of Clearing Account 18416</p>	<p>6.1 General ledger clearing account 18416 is used by SCL to record both sales and customer payments related to the Salvage Unit. Such balance sheet accounts typically carry a month-end balance due to timing differences¹² in recording transactions. At the end of each month, the account balance is reconciled by SCL General Accounting personnel to ensure all sales and related payments are accounted for and recorded accurately. At year-end, an entry is made to reclassify non-zero balances to a sundry accounts receivable account, bringing the balance in the 18416 account to zero.</p> <p>In our review of this account, we noted several concerns. The account for the three months selected for review was not (a) properly reconciled at month-end, as the research on account variances had not been completed; (b) timely reconciled, as the most recent reconciliation performed was March 2013;¹³ or (c) approved by</p>	<p>(1) SCL may not detect the misappropriation of customer payments if it does not perform complete and timely reconciliations of the 18416 account.</p> <p>(2) Without management review and approval of 18416 clearing account reconciliations, discrepancies may not be adequately investigated.</p> <p>(3) The lack of written accounting policies and procedures may result in inadequate account reconciliations.</p>	<p>(1) The 18416 clearing account should be reconciled by SCL accounting personnel soon after the end of each month. The SCL General Accounting Manager or an accounting supervisor should approve all account reconciliations, including the year-end balance reclassification, to ensure all variances have been appropriately identified and discrepancies timely resolved.</p> <p>(2) SCL should develop written accounting policies and procedures that include the reconciliation of the 18416 account.</p>

¹² Timing differences result when a sale is recorded in one month, while the corresponding payment is recorded in a different month.

¹³ Our review took place in December 2013. Reconciliations are performed monthly.

	FINDING	RISK	RECOMMENDATION
	management. The year-end journal entry to clear the 18416 account was approved by a senior accountant rather than the General Accounting Manager. In addition, there is no written accounting policy with regard to account 18416 reconciliations.		

Recommendation 6.1

SCL Management Response:

City Light Management has completed the reconciliation of account 18416 and will ensure the reconciliation is performed timely. The reconciliations are reviewed and approved according to the overall General and Cost accounting policies that are currently being updated. These policies will give guidelines for the timely completion and review and approval of all account reconciliations which will include this clearing account.

	FINDING	RISK	RECOMMENDATION
7.0 Reconciliation of Sales Documents	7.1 Salvage Unit sales transactions often generate supporting documentation, including weigh tickets, delivery receipts, and cash receipts. There is no independent reconciliation of the supporting documentation to the sales invoice by SCL personnel outside the Salvage Unit.	Deliberate attempts to exclude or misprice the materials may not be detected without supporting documentation.	Supporting documentation for all Salvage Unit sales should be reconciled to the surplus sales invoice by personnel independent of the Salvage Unit, such as Warehouse or Cost Accounting personnel. Reconciliation should include verification of pricing (e.g., use of appropriate contract pricing or reasonableness of courtesy sale pricing), and agreement of the invoice details to supporting documentation such as weigh tickets and cash receipt documents.

Recommendation 7.1

SCL Management Response

City Light Management evaluated their process and controls and does not plan to make any changes. Currently, FAS determines salvage prices on all but low dollar scrap courtesy sale items. The current process is that the sales documentation is maintained, reconciled, and reviewed by the General Warehouse Supervisor and Cost Accounting personnel who are both independent of the salvage crew performing the sales. City Light currently maintains all supporting documentation for salvage sales including weigh tickets, shipping manifests, delivery receipts, and cash receipts. These documents are reviewed by the Senior Warehouse and forwarded to the General Warehouse Supervisor. The General Warehouse Supervisor reviews the documentation, logs the information in a salvage sales spreadsheet and forwards the spreadsheet and all cash receipts to cost accounting for review and reconciliation to the general ledger. When the sales documentation is for a large bid sale the General Warehouse Supervisor also forwards the sales documentation to the Inventory Crew Chief in order to reconcile the Passport Log used by salvage crews to estimate the bid sale.

	FINDING	RISK	RECOMMENDATION
8.0 Blanket Sales Transactions Documentation of Customer Acceptance	8.1 Blanket contracts (aka "B Contracts") are used to facilitate the sales of certain Salvage Unit materials, such as used transformers, under pre-determined pricing agreements. Personal bills of sale (PB) are used as invoices for the purchases of blanket contract items and contain a waiver and release provision. The waiver and release protects SCL from liability in the event of customer injury incurred while removing materials from the South Service Center and also provides for customer acceptance of the materials on an as-is basis without guarantee of condition or	SCL may be exposed to liability for injury and may be required to assume responsibility for the fitness and performance of goods sold.	SCL management should enforce compliance with current policies and procedures that require the signatures on all PBs. ¹⁴

¹⁴ DPP 500, I-705, Section 4.10.

	FINDING	RISK	RECOMMENDATION
	<p>performance. The customer is required to sign the PB to make these provisions binding.</p> <p>In 18 out of 22 blanket contract sales tested by F&C, there were no customer signatures on the PBs.</p>		

Recommendation 8.1

SCL Management Response

City Light Management changed this process as of 1/1/2014 and now only uses pre-numbered Personal Bills of Sale for all salvage sale transactions. The General Warehouse Supervisor directed the salvage personnel to comply with the policies and procedures and obtain the needed signatures on the personal bills of sale.

	FINDING	RISK	RECOMMENDATION
<p>Support Documentation for Blanket Contract Agreements</p>	<p>8.2 Transformers sold under blanket contract agreements may be sold by weight or by capacity (KVA rating), depending on the capacity rating. Transformers sold by weight are required to be weighed in order to calculate the appropriate price. Weigh tickets are generated as verification of the total weight.</p> <p>During F&C's testing of blanket contract sales, they noted transformers that were sold by weight were lacking supporting weigh ticket documentation. Further, some of the blanket contract sales</p>	<p>(1) The omission of transformer capacity information (KVA rating) or supporting weigh tickets presents an opportunity to sell the equipment below contract prices in exchange for a kickback from the customer.</p> <p>(2) After taking delivery of the materials, customers may later dispute the weight of the transformers and request an inappropriate refund.</p>	<p>(1) SCL's written policies that govern Salvage Unit activities should require that all sales of salvage materials contain supporting documentation, including weigh tickets, shipping manifests, delivery receipts, and cash receipts. The invoice should be reconciled to the supporting documentation by personnel independent of the Salvage Unit.</p> <p>(2) All weigh tickets should be signed by the customer.</p> <p>(3) All transformers should have their specified KVA ratings noted</p>

	FINDING	RISK	RECOMMENDATION
	tested did not have sufficient information on the personal bills of sale to determine whether the transformers should have been sold by weight or by capacity.		on the personal bill of sale. Supporting documents should be reconciled to the invoice (see Recommendation 7.1 above).

Recommendation 8.2

SCL Management Response

City Light Management evaluated their process and controls and started retaining all the weight tickets rather than just the final weight ticket for bid sales.

The current process and process during the audit period was that City Light maintains all supporting documentation for salvage sales including weigh tickets, shipping manifests, delivery receipts, KVA information and cash receipts. These documents are reviewed by the Senior Warehouser and General Warehouse Supervisor.

It is not clear from the concern whether salvage personnel provided all the supporting documentation to Francis and Co. at the time of the audit. The documentation is shared by other groups. For example, support for transformer sales is gathered, weighed or calculated by toxic waste crews and faxed to the vendor separate from the personal bill of sale and prior to pick up. This support documentation was never provided to audit staff nor reviewed during audit testing. As a result of the audit the General Warehouse Supervisor is now attaching all supporting documentation to the personal bills of sale instead of filing this paperwork separately. To our knowledge there has never been a dispute over the weight or KVA calculation from our vendors and none was found during the audit. City Light Management does not plan on making any additional changes to the current process.

	FINDING	RISK	RECOMMENDATION
9.0 Salvage Unit Personnel – Duty Segregation	9.1 Salvage Unit personnel currently collect customer payments for courtesy sales (aka sundry sales) and transformers sold through “B Contract” sales. In addition to collecting customer payments, Salvage Unit personnel also authorize the price for courtesy sales, while for both courtesy and “B Contract” sales, they write the invoice and maintain custody of the materials for delivery to the customer.	The receipt of customer payments is incompatible with other duties performed by Salvage Unit personnel, as noted in the finding, and creates the opportunity for the misappropriation of customer payments.	SCL management should immediately require that all customer payments be directed to personnel independent of the Salvage Unit, such as SCL cashiers currently located at the South Service Center. ¹⁵ Payments relating to contract sales should be made directly to FAS Treasury, as required by SCL policy. ¹⁶

Recommendation 9.1

SCL Management Response:

City Light Management evaluated their process and controls and does not plan to make any immediate changes to the receipt of customer payments. For contract sales, City Light Management will collaborate with FAS Treasury in order to re-evaluate the risks. City Light plans to make a final determination by mid-2014.

The current facility layout makes this requirement difficult. Requiring customers to remit all payments to the cashier located at the north end of the South Service Center requires that they would need to enter and exit the facility several times, leave their vehicles unattended and increase the chances that customers will not be accompanied by City Light employees. The South Service Center has constant heavy equipment traffic, areas that require hard hats and reflective vests, and secure access areas off limits to the general public. City Light maintains a cash box at the salvage office to limit the safety and security risks of the general public entering the South Service Center. The front gate layout is planned for remodel in 2014 which may mitigate the safety and security risks stated above. Currently, cash sales receipts are reviewed by the Senior or Chief Warehouse and forwarded to the General Warehouse Supervisor. The General Warehouse Supervisor

¹⁵ Baker Tilly, SCL’s external auditor, conducted an audit of SCL’s payment receipt processes in 2012 and recommended that collections of small sales be administered by the service center cashier rather than the surplus yard. Our recommendation echoes their concern.

¹⁶ DPP 500, I-705, Section 7.4.4.1.

reviews the sales documentation, logs the information in a salvage sales spreadsheet and forwards the spreadsheet and all cash receipts to cost accounting for review and reconciliation to the general ledger. In addition, customer personal bill of sales are collected by security prior to a customer leaving the South Service Center.

Office of City Auditor Comment

The mitigating controls cited by SCL in their response above, in our opinion, are inadequate to detect the potential misappropriation of customer payments. We encourage SCL to reconsider the implementation of our recommendation above.

	FINDING	RISK	RECOMMENDATION
10.0 Policies and Procedures Update	10.1 The governing policy at SCL for the disposition of surplus materials is DPP 500, I-705. The policy is required to be reviewed and updated annually as necessary. The last update, however, was made in May 1999.	The lack of updated policies and procedures increases the risk of non-compliance and may compromise currently designed controls.	(1) SCL management should annually review and update, as necessary, policies and procedures regarding the disposition of surplus property as required in section 6.10.9 of the policy, and provide adequate training to affected personnel to ensure compliance. (2) Other policies and procedures that relate to surplus sales operations, such as those drafted by SCL's Security unit, should also be reviewed and updated as necessary, at least annually.

Recommendation 10.1

SCL Management Response

City Light Management agrees that the policy needs to be updated and reviewed periodically to ensure it reflects current practice. City Light Department Policy and Procedure 500 PI-705: DISPOSITION OF SURPLUS, OBSOLETE, JUNK AND SCRAP MATERIALS, SUPPLIES, AND EQUIPMENT has remained unchanged since May of 1999. This DPP is currently being revised to reflect our current processes and will be submitted to be adopted by 6/30/14. City Light management will continue evaluating where better-documented policies and procedures are warranted and update as necessary, communicate expectations to staff and provide training if necessary. In addition, Corporate Security is currently updating their security guard orders.

	FINDING	RISK	RECOMMENDATION
11.0 Authorization for Disposition of Surplus Materials/Equipment	11.1 SCL's governing policy for surplus sales states that FAS shall determine the method of disposition of surplus property. ¹⁷ Section 7.2.2.1 from the policy states that FAS provides Salvage Unit personnel with blanket authorization to sell a specified list of items ¹⁸ through courtesy sales. According to the FAS Warehouse Manager, the blanket authorization has not been issued.	High dollar items already directed to be sold through sealed bid, Bidadoo, "B Contract" or other sales channels may instead be intentionally sold through courtesy sales for which there are currently no controls over pricing and the handling of customer payments. This condition creates the opportunity for the misappropriation of high dollar materials and customer payments.	(1) FAS should issue the blanket authorization for the sale of courtesy items as required by policy. FAS should also define, in writing, materials and equipment that should be sold through contracts and bid sales, and update the list as necessary. (2) Monitoring controls should be implemented by FAS management to help ensure that surplus items are sold in accordance with the authorization.

Recommendation 11.1

The Department of Finance and Administrative Services provided the following:

The Department of Finance and Administrative Services (Warehousing Services) will provide written guidelines to City Light to identify the low-value, miscellaneous material and equipment that it is efficient to offer for sale through the City Light Surplus Warehouse. We will continue to regularly visit the City Light Surplus Warehouse to verify that the material they offer for sale is consistent with our expectations and the new written guidelines.

FAS stated also that they expect to have guidelines drafted by mid-2014.

¹⁷ DPP 500, I-705, Section 4.6.

¹⁸ Section 6.10.10 states that the General Warehouse Supervisor submits items to FAS for authorization annually.

	FINDING	RISK	RECOMMENDATION
<p>12.0 Authorization for the Donation of Surplus Assets</p>	<p>12.1 On April 23, 2013, after F&C completed their field work at the SCL Salvage Yard, two men who said they were from a non-profit organization requested a donation of copper wire from SCL's Salvage Unit. SCL executive management granted their request and authorized a donation of a "small amount" of scrap material (copper wire). The authorization was given verbally by SCL's Superintendent to the Director of Energy Delivery Operations. However, the two men were able to take far more materials than SCL management intended to donate. The two men took 40,450 pounds of copper wire valued at approximately \$114,000. The men were subsequently arrested by police and charged with theft. SCL personnel did not follow established Seattle city code or FAS and SCL department policies regarding the donation of surplus property.¹⁹ Such codes and policies require that FAS, not SCL, determine the method of disposition, including transfer of surplus materials to a non-profit agency.</p>	<p>The circumvention of established City codes and City department policies allowed the alleged theft to occur.</p>	<p>SCL management should ensure that all personnel involved in surplus sales operations, either directly or indirectly, including managers and supervisors, are trained to understand and follow City policies regarding the donation of surplus assets. SCL should establish procedures as to how to respond to future requests for donations of surplus assets.</p>

¹⁹ Seattle Ordinance 123361,3.39.020 (N); FAS department policy DEA 07-01, Section VI(F); SCL department policy DPP 500, I-705, Section 4.6

Recommendation 12.1**SCL Management Response**

City Light Management agrees and has developed new sponsorship guidelines that include an explicit reminder that gifts/donations of public funds are prohibited. The guidelines were issued and communicated April 7, 2014.

The full amount of stolen copper was located shortly after the scam and subsequently returned to the possession of City Light.