



CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

7

July 12, 2004

**The Honorable City Council
Palo Alto, California**

Auditor's Office Quarterly Report

At its meeting on June 1, 2004, the Finance Committee unanimously recommended to the City Council acceptance of the Auditor's Office Quarterly Report as of May 31, 2004. Excerpted minutes of the meeting are attached.

Respectfully submitted,

//:s
Sharon W. Erickson
City Auditor



CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

June 1, 2004

The Honorable City Council
Attn: Finance Committee
Palo Alto, California

Auditor's Office Quarterly Report

RECOMMENDATION

The City Auditor's Office recommends the Finance Committee review and recommend to the City Council acceptance of the Auditor's Office Quarterly Report.

SUMMARY OF RESULTS

In accordance with the Municipal Code, the City Auditor prepares an annual work plan for approval by the City Council, and issues quarterly reports to the City Council describing the status and progress towards completion of the work plan. The purpose of this report is to provide the City Council with a status report on the activities of the Office for the period ending May 31, 2004.

We issued the following reports to the City Council since our last status report in February 2004:

- 2 Informational reports on Palo Alto sales tax (February 2004 and April 2004)
- Audit of Restructuring Efforts and Management Span of Control (April 2004)
- Review of the City's write-off policy for not sufficient funds checks (May 2004)

Our revenue audits are yielding benefits to the General Fund. The City has received **\$140,461** since July 1, 2003 as a result of our in-house and contracted audits (our goal is \$235,000 in audit recoveries for the fiscal year). This includes \$33,985 in sales tax, \$4,125 in documentary transfer tax, and \$102,351 in utility users tax.

I am very pleased to report that on May 25, 2004, the City Auditor's Office received the Knighton Award for best performance audit report in the small audit shop category from the National Association of Local Government Auditors (N.A.L.G.A.) for our recent *Audit of the Development Review Process*. Independent judges from the Association evaluate submitted reports on the basis of their scope and potential for significant impact, the persuasiveness of their conclusions, the focus of their recommendations on effective and efficient government, their clear and concise communications style, and their innovation. Senior auditor Edwin Young and I were honored with a free trip to Richmond, Virginia, to accept the award and present a summary of our report to

delegates from local government audit shops from around the U.S. and Canada at the N.A.L.G.A. annual conference.

The following projects are in process (with target completion dates):

- Audit of cable franchise fees and customer service provisions (TBD)
- Audit of contract contingency dollars (Fall-2004)
- Audit of the workers' compensation program (Fall-2004)
- Controls review of the SAP computer system (on-going)
- Audits of sales, property, and utility users' tax revenues (on-going)

Information on the status of each assigned project is attached (pages A-1 through A-6). On behalf of the Auditor's Office, I would like to express my appreciation to City staff for their cooperation and assistance during our reviews.

Respectfully submitted,

Sharon W. Erickson
City Auditor

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Attachment: City Auditor Project Status as of May 31, 2004

City Auditor Project Status as of May 31, 2004

Original Audit Project Description and Preliminary Objectives	Status	Accomplishments Year-To-Date	Items to be Completed
CARRYOVER ASSIGNMENTS IN PROCESS			
1. Audit of the Development Review Process – The objective of this audit was to evaluate the efficiency and effectiveness of the City’s handling of proposed development projects.	Completed	Report issued Oct-2003 with 34 recommendations to improve turnaround times, and to clarify and simplify the development review process.	
2. Audit of Overtime Usage – The purpose of this audit is to review actual overtime usage and identify opportunities to better control overtime expenditures.	Completed	Report issued Nov-2003 with 32 recommendations to reduce overtime expense and improve accountability for overtime use.	
3. Audit of Cable Franchise Fees and Customer Service Provisions (contracted audit service to be funded by the joint powers authority) – This audit will provide independent verification of franchise fee payments and customer service reporting to ensure compliance with provisions in the Municipal Code and franchise agreement standards.	In process	A City Council public hearing was held in Oct-2003 to initiate the audit. The Buske Group (funded by the cable JPA) has been retained to perform the audit. Comcast was responsive to the Buske Group’s requests for information related to compliance with the franchise agreement, but has not been responsive to Buske’s requests for information related to franchise fees. We are conferring with the City Attorney’s Office and Comcast regarding possible courses of action.	Target completion date: Jul-2004.
ON-GOING ASSIGNMENTS AND RESPONSIBILITIES			
4. Annual External Audit – The City Charter requires that the City Council engage an independent certified public accounting firm to conduct an annual external audit. The City Auditor coordinates the annual external audit. Maze & Associates has conducted the audit for the past five years.	Completed	Maze & Associates completed the audit of the June 30, 2003 financial statements, and issued a clean opinion.	
5. Revenue Audits – The Office contracts with outside vendors to provide the following audit services: <ul style="list-style-type: none"> a. <i>Sales Tax</i> – Sales tax represents about 16 percent or \$19 million of General Fund revenue. We contract with HdL Companies for 	On-going	HdL Companies prepares quarterly	On-going

Original Audit Project Description and Preliminary Objectives	Status	Accomplishments Year-To-Date	Items to be Completed
<p>quarterly sales tax audit and information services. Audits focus on verifying that Palo Alto is getting its appropriate share of sales tax allocations. HdL's fee is 15% of audit recoveries.</p>		<p>sales tax reports for the City. Reports were issued in Jul-2003 (regarding 1st quarter 2003 sales tax), Nov-2003 (regarding 2nd quarter 2003 sales tax), Feb-2003 (regarding 3rd quarter 2004 sales tax), and May-2004 (regarding 4th quarter sales tax).</p> <p>In the first quarter 2003-04, the City received a total of \$19,429 in sales tax recoveries related to misallocation of tax from 6 Palo Alto companies. This included \$15,179 as a result of audits conducted by the City Auditor's Office, \$339 as a result of audits conducted by our previous sales tax auditors MBIA, and \$3,911 as a result of audits conducted by HdL Companies.</p> <p>In the second quarter 2003-04, staff in our office identified 2 additional Palo Alto businesses with sales tax issues; we received \$4,446 to date as a result of those efforts. In addition, HdL staff identified one company whose tax was misallocated.</p> <p>In the third quarter 2003-04, we collected \$10,110, including \$4,432 as a result of audits conducted by the City Auditor's Office, and \$5,678 as a result of audits conducted by</p>	<p>Informational report on sales taxes for 2nd quarter 2004. Target date: Aug-2004.</p>

Original Audit Project Description and Preliminary Objectives	Status	Accomplishments Year-To-Date	Items to be Completed
		HdL Companies. Sales tax recoveries year-to-date: \$33,985	
<p>b. <i>Property Tax</i> – Property tax represents about 11 percent or \$13.6 million of General Fund revenue. We are contracting with HdL Property Tax Services for property tax auditing and information services. Audit services are designed to ensure that County assessment data for properties in Palo Alto is current and accurate. HdL's fee is 15% of audit recoveries.</p>	On-going		On-going
<p>c. <i>Documentary Transfer Tax</i> – The documentary transfer tax (approximately \$3 million annually) is a one-time tax that is levied when residential and commercial properties are sold. We have contracted with HdL Coren & Cone to test County data to ensure that transfer taxes are being properly applied and remitted timely. HdL's fee is 15% of audit recoveries.</p>	Completed	In Mar-2004, HdL Companies conducted a review of Documentary Transfer Tax for fiscal year 2002-03, and identified \$4,125 for redistribution to the City.	Target date for next documentary transfer tax review: Mar-2005.
<p>d. <i>Utility Users Tax (UUT)</i> – UUT is calculated at 5 percent of electricity, gas, water, and telephone service (generating about \$7 million annually). We have contracted with Tax Compliance Services to audit telecommunications companies' UUT remittances.</p>	In process	<p>In Jul-2002, we contacted and requested information from the 210 telephone service providers who have remitted UUT payments to the City of Palo Alto. In Oct-2002, we sent out reminders to those providers who had not yet provided documentation to substantiate their UUT payments.</p> <p>In Jul-2003, Revenue Collections mailed assessment letters totaling more than \$1 million to 105 telephone service providers who had not responded to our requests for auditable records. These amounts represent good faith estimates of their underpayment of</p>	Target completion date: Jun-2004.

Original Audit Project Description and Preliminary Objectives	Status	Accomplishments Year-To-Date	Items to be Completed
		<p>tax. 20 companies requested administrative hearings and/or provided additional information. We have completed the first round of hearings, and currently estimate that telephone service providers owe the City a total of about \$1.1 million. Additional hearings and appeals are possible.</p> <p>During the audit, we also noted that a major telephone provider has never remitted UUT to the city of Palo Alto. In Aug-2003, Revenue Collections notified the provider of this fact, requesting immediate payment. To date, we still have not received any payment from this provider. The matter has been referred to outside counsel.</p> <p>UUT recoveries year-to-date: \$102,351</p>	
<p>6. Streamlining Initiatives – As time allows, the Auditor's Office makes itself available to (1) independently assess the cost/benefit of streamlining projects, and (2) provide advice on the adequacy of streamlined controls and procedures. Projects this year include:</p> <p>a. <i>Infrastructure Contract Streamlining Committee</i> – The Office issued a report on contract processing times in April 2002. The City Auditor will provide advice to the Committee as needed regarding proposed changes to contracting procedures.</p> <p>b. <i>Reviewing the City's write-off policy for NSF (not sufficient funds) checks less than \$25 (carryover project from 2002-03).</i></p>	<p>In process</p> <p>Completed</p>	<p>Revisions to streamline the purchasing ordinance were approved by the City Council in May-2004.</p> <p>Report issued Jun-2004 with one recommendation to increase the returned check fee.</p>	<p>On-going review of proposed changes to contracting procedures.</p>
<p>7. Reviews of Financial Procedures and Controls – The Municipal Code outlines the City Auditor's role in reviewing the financial and accounting procedures of the City. Projects this year include:</p>			
<p>a. <i>Controls Review of SAP</i> – The implementation of SAP software will have dramatic impacts on the City's business operations and financial</p>	<p>On-going</p>	<p>We have conducted limited testing to verify that edit features, audit trails, and</p>	<p>On-going.</p>

Original Audit Project Description and Preliminary Objectives	Status	Accomplishments Year-To-Date	Items to be Completed
<p>records. As part of the original implementation plan, ASD contracted with the Government Finance Officer's Association (GFOA) for assistance services. In addition, the Auditor's Office will continue to monitor the implementation and provide advice to ASD on the adequacy of controls in the new system.</p>		<p>transaction reports are operational as part of SAP phase 1 and phase 2 implementation.</p>	
<p>b. <i>Cash Controls (carryover from 2002-03)</i> – Verify that the Golf Professional's procedures for handling golf course receipts conform to City procedures.</p>	<p>Assigned to external auditor</p>		<p>The City's external auditor, Maze and Associates, will conduct this review as part of their interim audit work. Target completion date: Dec-2004.</p>
<p>c. <i>Additional assistance as requested.</i></p>	<p>Completed</p>	<p>In Mar-2004, the Administrative Services Department asked the Auditor's Office to review the documentation that was submitted to the Purchasing Division regarding a contract for public art. We investigated the status of the project, determined that centralized purchasing requirements and procedures apply, and provided specific advice to ensure that the project we reviewed, and future public art requests for proposals and contracts, adhere to those requirements.</p>	
<p>8. Service Efforts and Accomplishments (SEA) Report – Issue second annual SEA report summarizing workload and results information for the City's major public services for 2002-03, providing benchmark comparisons to comparable jurisdictions.</p> <p>a. <i>Citizen survey</i> – Incorporate the results of a citizen survey. The purpose of the survey is to provide baseline information about customer satisfaction on core City services.</p>	<p>Completed</p>	<p>Report issued January 29, 2004. The results of the citizen survey were incorporated into the report, and the full results of the survey were attached to the report.</p> <p>Palo Alto is a charter participant in the Association of Government Accounts' pilot certification program for Service Efforts & Accomplishments Reporting, and the City Auditor is a pilot phase reviewer in the program.</p>	<p>Target date for next SEA report: Dec-2004.</p>
<p>9. Other Responsibilities:</p> <p>a. <i>Audit Recommendation Status</i> – The</p>	<p>On-going</p>	<p>Report issued Oct-2003 for review by the</p>	<p>Target date for next audit</p>

Original Audit Project Description and Preliminary Objectives	Status	Accomplishments Year-To-Date	Items to be Completed
City Auditor issues an annual report on the status of recommendations from recently completed audits.		Finance and Policy & Services Committees. The City Auditor will work with the City Manager's Office to encourage early implementation of recommendations, and to track performance against target dates.	recommendation status report: Jul-2004.
b. <i>Annual Work Plan and Quarterly Status Reports</i> – The City Auditor submits quarterly reports to the City Council outlining project status and progress towards completing the assignments on this annual work plan.	On-going	In Aug-2003 the City Council approved the 2003-04 Work Plan. Quarterly status reports were issued in Aug-2003, Oct-2003, Feb-2003, and May-2003.	Target date for next annual audit work plan: Jul-2004.
c. <i>Executive Staff</i> – To facilitate communication and coordination of efforts, the City Auditor attends the City Manager's weekly executive staff meetings.	On-going		
d. <i>Utility Risk Oversight Committee (ROC)</i> – As a consequence of our <i>Assessment of Utility Risk Management Procedures</i> (report issued July 2002), the City Auditor acts as an advisor to the ROC to facilitate implementation of the audit recommendations.	On-going		
<u>2003-04 AUDIT ASSIGNMENTS</u>			
10. Audit of restructuring efforts and management span of control – The Auditor's Office will conduct an independent review of General Fund and Internal Service Fund staffing changes and restructuring over the last two years, and assess the feasibility of additional reductions through attrition. We will include a listing with explanations of all job duties for management/ supervisory positions with four or fewer direct reports. We will evaluate supervisory span of control, the ratio of managers to line staff, and the number of levels of management review by department.	Completed	Report issued Apr-2004 including 17 recommendations to improve controls and actively manage the City's organizational structure.	

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<p>11. Organizational review of the Community Services Department (CSD) – CSD is the City’s largest department with more than 200 employees and a \$24.8 million operating budget, including \$14.4 million in salaries and benefits. The audit will build on previous staffing studies (e.g. the 2001 library staffing study), and focus on the question of whether the department is optimally organized to deliver services.</p>	Deferred (not started)	The City Auditor, Finance Committee, and City Council agreed to delay the audit while Department restructures around vacancies.	Return to Finance Committee by Sep-2004 with recommendation as to when the audit could begin.
<p>12. Public communications expenses – Staff is initiating a self-audit of public communications expenses citywide including print and electronic publications and staffing. The City Auditor will assist their review by helping define the scope of the review, reviewing findings, and making recommendations based on findings and in consultation with staff.</p>	Completed	Report issued May-2004 with recommendations to improve efficiencies in print and web publications.	
<p>13. Audit of Contract Contingencies– The objective of this audit is to evaluate (1) the appropriateness of contingency levels, (2) the approval process for the use of contract contingencies, and (3) actual contingency usage.</p>	In process	We are in the preliminary survey phase of the audit.	Target completion date: Fall-2004.
<p>14. Review of the Workers’ Compensation Program – The City has been self-insured for Workers’ Compensation since 1979. The purpose of this review is to identify opportunities to control costs.</p>	In process	We are in the preliminary survey phase of the audit.	Target completion date: Fall-2004.
<p>15. Police property room and informant fund – The Police Department desires independent audits of the property room and informant fund. It is likely that we can contract with an outside vendor for these services at minimal cost.</p>	Not started		Target completion date: TBD.