



CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

November 7, 2006

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

Auditor's Office Quarterly Report as of September 30, 2006

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 as of September 30, 2006.

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. This report provides the City Council with an update on the activities of the Office as of September 30, 2006.

We issued the following reports to the City Council since our last status report in July 2006:

- Informational report on Q1-2006 Palo Alto sales tax (Jul-2006)
- City Auditor's fiscal year 2006-07 work plan (Sep-2006)
- Audit of Community Services Department class cost recovery (Oct-2006)

Also this quarter, Tax Compliance Services completed an audit of transient occupancy taxes, finding a very high degree of compliance with the local tax; and at the request of the Santa Clara County Civil Grand Jury, we provided information about Palo Alto's audit function and SEA report (see attached).

Our revenue audits continue to yield benefits to the General Fund. The City has received \$37,621 during the fiscal year to date as a result of our in-house and contracted audits (our goal is \$235,000 in audit recoveries). This includes \$35,019 in sales tax, and \$2,602 in transient occupancy tax, and does not include audit findings that were assessed but have not yet been collected.

In addition to our on-going assignments, the following projects are in process (with target completion dates):

- Report on the status of audit recommendations (Nov-2006)
- Service Efforts and Accomplishments Report FY 2005-06 (Dec-2006)
- Audit of the Waste Management/PASCO contract (Dec-2006)
- Audit of Library operations (Apr-2007)
- Infrastructure report card (TBD)
- Review of ethics policies (TBD)

Information on the status of each assigned project is attached (pages A-1 through A-4). 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

Sharon W. Erickson

City Auditor

Attachment: Status of Audit Projects as of September 30, 2006
Letter from Santa Clara County Civil Grand Jury

Status of Audit Projects as of September 30, 2006

Original Audit Project Description and Preliminary Objectives	Status	Accomplishments Year-To-Date	Items to be Completed
AUDIT ADMINISTRATION, FOLLOW-UP, AND OTHER RESPONSIBILITIES			
1. Annual work plan and quarterly status reports – The Auditor’s Office submits quarterly reports to the City Council outlining project status and progress towards completing the assignments on this annual work plan.	On-going	In Sep-2006, the Finance Committee recommended approval of the FY 2006-07 work plan. This is the first quarterly report as of September 30, 2006.	The recommendation to approve the work plan is on the City Council agenda for November 6 th .
2. Audit recommendation status report – The Municipal Code requires the City Auditor to issue an annual report on the implementation status of recommendations from recently completed audits. We also meet with involved departments mid-year to discuss progress towards implementing open audit recommendations.	On-going	The report summarizes the status of 143 recommendations. In the last year, City staff completed 77 recommendations and worked on or partly implemented an additional 50 recommendations. 16 recommendations are not started.	Review by the Finance Committee on November 7 th and the Policy & Services Committee on November 8 th .
3. Meeting attendance – To facilitate communication and coordination of efforts, the City Auditor attends the City Council meetings, Finance Committee meetings, and the City Manager’s weekly executive staff meetings.	On-going		
4. Utility Risk Oversight Committee (UROC) – Since issuance of our <i>Assessment of Utility Risk Management Procedures</i> in Jul-2002, the City Auditor has acted as an advisor to the UROC. Our citywide risk assessment model continues to target the various utility funds including wastewater treatment, electric, water, and wastewater collection.	On-going		
REVENUE AUDITS¹			
5. Sales tax allocation reviews (on-going) – Sales tax represents about 18 percent, or \$21.1 million, of projected General Fund revenue for 2006-07. We contract with MBIA MuniServices (MMC) for quarterly sales tax audit and information services. MMC’s quarterly sales tax information reports are public, and are provided to the City Council as information items. We also conduct sales tax	On-going	MMC continues to provide quarterly sales tax information reports. The report summarizing Q1-2006 sales was distributed Jul-2006. In the first quarter of FY 2006-07, the City	Next quarterly sales tax information report: Nov-2006.

¹ We conduct our revenue audits in accordance with applicable government auditing standards, and report the results of our revenue audits in the Auditor’s Office Quarterly Report. In accordance with state law, confidential information about specific businesses is not included in these reports.

Original Audit Project Description and Preliminary Objectives	Status	Accomplishments Year-To-Date	Items to be Completed
audits in-house. Both types of audits focus on verifying that Palo Alto is getting the appropriate allocation of local sales tax.		<p>received \$35,019 in sales tax recoveries related to misallocation of tax from 5 Palo Alto companies. This amount is the result of audits conducted earlier by our previous sales tax consultant, Hinderliter de Llamas & Associates (HdL), MMC, and the City Auditor's Office.</p> <p>In addition, there are potential misallocations from 10 companies pending resolution by the State Board of Equalization. MMC identified the potential misallocations from 3 of the companies, and the City Auditor's Office identified the potential misallocations from the other 7 companies.</p> <p>Sales tax recoveries year-to-date: \$35,019</p>	
<p>6. Transient occupancy tax audit (in process) – Transient occupancy tax represents about 6 percent of General Fund revenues, or about \$6.4 million per year. Tax Compliance Services (TCS) is conducting the audit. TCS previously audited TOT revenues through Jun-2002.</p>	Completed	<p>TCS completed the audit of all 28 hotels/motels in Palo Alto in Aug-2006. The audit identified a total of \$15,387 in underreporting and errors. This is an error rate of only 0.2% – demonstrating a very high level of compliance by local hotels and motels. As a follow-up to the audit, we are working with ASD to locate and notify owners of facilities with potential short-term rentals about the applicability of TOT.</p> <p>TOT recoveries year-to-date: \$2,602</p>	
FINANCIAL AUDITS AND PROCEDURAL REVIEWS			
<p>7. Annual external financial audit (contracted audit service) – The City Charter requires that the City Council engage an independent certified public accounting firm to conduct an annual external audit. This is the second year of a three-year contract with Maze & Associates.</p>	In process	<p>In Apr-2006, Maze began interim audit work in preparation for the audit of the June 30, 2006 financial statements. Fieldwork is now complete.</p>	Target date: Dec-2006
<p>8. Audit of the police investigative fund – Pursuant to Police Department procedures, the Auditor's Office conducts a surprise</p>	Not started		Target date: TBD

Original Audit Project Description and Preliminary Objectives	Status	Accomplishments Year-To-Date	Items to be Completed
review on an annual basis.			
9. Review of ethics policies (in process) – The purpose of this project is to review procedures for ascertaining and handling potential conflicts of interest among city employees, and assess the need for an ethics policy.	In process	We are in the preliminary survey phase of this review – determining what policies are currently in place and where additions might be needed.	Target date: TBD
10. <NEW> Audit of SAP payroll controls – The purpose of this review would be to assess the adequacy of controls over the SAP payroll module including data entry, approvals, and payment processing.	Not started		Target date: TBD
PERFORMANCE AUDITS AND SPECIAL PROJECTS			
11. Audit of CSD class program cost recovery – The purpose of this audit was to determine the income/subsidy of class programs net of direct and indirect costs.	Completed	Report issued Oct-2006. The report included 8 recommendations to address cost recovery.	
12. Infrastructure report card – The purpose of this project is to assess the impact of increased capital spending on the City's infrastructure, including utilities. The Capital Improvement Program was one of the areas targeted by our citywide risk assessment model.	In process	We are in the fieldwork phase of this project – reviewing available information about Palo Alto's level of spending, and summarizing the condition and value of Palo Alto's infrastructure assets.	Target completion date: TBD
13. Audit of the Waste Management/PASCO contract – In anticipation of the 2009 termination date of the current agreement, staff requested the auditors review the agreement. The estimated payment to PASCO for refuse collection, hauling, and disposal in 2006-07 is about \$8.6 million.	In process	We are in the preliminary survey phase of this project, and are doing preliminary investigation to determine the scope of our review.	Target completion date: Dec-2006
14. Service Efforts and Accomplishments (SEA) Report – This will be the 5 th annual SEA report. The purpose of SEA reporting is to strengthen public accountability and help improve government efficiency and effectiveness. Palo Alto's SEA report provides data about the costs, quality, quantity, and timeliness of City services. It includes a variety of comparisons to other cities, and the results of an annual citizen survey (the National Citizen Survey).	In process	We are in the data-gathering stage. The National Research Center mailed surveys to 1,200 Palo Alto residents in September, and is processing the results.	Target completion date: Dec-2006
15. Audit of Library operations – The purpose of our review is to identify potential operating efficiencies and cost savings.	In process	We are in the preliminary survey phase of this project, and are doing preliminary investigation to determine the scope of our review.	Target completion date: Apr-2007

Original Audit Project Description and Preliminary Objectives	Status	Accomplishments Year-To-Date	Items to be Completed
<p>16. Audit of vehicle replacement and maintenance fund (carryover from FY 2005-06) – This internal service fund has 16 full-time equivalent employees and projected 2006-07 expenditures of \$6.7 million. The vehicle replacement and maintenance fund was one of the areas targeted by our citywide risk assessment model. The purpose of this review is to evaluate economy, efficiency and effectiveness of fleet and equipment replacement and maintenance operations.</p>	Not started		Target date: TBD
<p>17. Police community survey – The Auditor’s Office will conduct a second annual survey of drivers of vehicles that are stopped to determine how they feel they were treated during the stop, and a comparison survey of persons requesting service.</p>	Not started		Target date: TBD
<p>18. EMS ambulance transport service billing and revenue collection – In FY 2004-05, the Palo Alto Fire Department responded to about 3,600 medical/rescue calls, and transported about 2,744 individuals. The purpose of this review would be to assess the overall efficiency and cost effectiveness of EMS billing and collections.</p>	Not started		Target date: TBD
<p>19. Public-private partnership reviews – The Auditor’s Office will assist in reviewing the expected proposal from the Friends of the Palo Alto Junior Museum & Zoo (PAJMZ) to operate the PAJMZ, and the proposed analysis of golf course operations.</p>	Not started		Target date: TBD
<p>20. Wastewater Treatment Fund – The Regional Water Quality Control Plant provides services to Mountain View, Los Altos, Los Altos Hills, Stanford, and East Palo Alto. With proposed revenues of \$22.5 million, proposed expenditures of \$24.4 million, a \$16.9 million five-year capital plan, and 69 full-time equivalent employees, this is one of the areas consistently targeted by our annual citywide risk assessment model. The purpose of our audit is to review the cost-sharing agreements and allocation of charges to partner agencies.</p>	Not started		Target date: TBD



September 15, 2006

Ms Sharon W Erickson, City Auditor
City of Palo Alto
Office of the City Auditor
250 Hamilton Avenue
Palo Alto, CA 94301

Dear Ms Erickson,

Thank you very much for your presentation to the Santa Clara County Civil Grand Jury. We were all very interested in your work.

We were impressed by the scope of your work ranging from follow-up of previous audit recommendations, to ongoing revenue audits, to performance audits and policy reviews. You are quite efficient with the small staff that you manage. The *Service Efforts and Accomplishments Report* is a truly impressive and informative document. We would be well served if all of the municipalities in Santa Clara County had the interest and resources to maintain such a record.

Thank you again for your work and for taking the time to speak to us.

Sincerely,

A handwritten signature in black ink, appearing to read 'Ronald R Layman', with a long horizontal flourish extending to the right.

Ronald R Layman, Foreperson
2006-07 Santa Clara County Civil Grand Jury
191 North First Street
San Jose, CA 95113