



## CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

September 14, 2009

The Honorable City Council  
Palo Alto, California

### Finance Committee Recommendation to Accept the Auditor's Office Quarterly Report as of June 30, 2009

At its meeting on July 21, 2009, the Finance Committee unanimously recommended to the City Council acceptance of the Auditor's Office Quarterly Report as of June 30, 2009. Minutes of the meeting are attached.

Respectfully submitted,

A handwritten signature in cursive script that reads "Lynda Flores Brouchoud".

Lynda Flores Brouchoud  
City Auditor

Attachments:

- *Attachment 1* - Auditor's Office Quarterly Report as of July 21, 2009
- *Attachment 2* - Finance Committee Minutes of July 21, 2009 pgs 19-20



## CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

July 21, 2009

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

### Auditor's Office Quarterly Report as of June 30, 2009

#### 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 June 30, 2009.

#### SUMMARY OF RESULTS

In accordance with the Municipal Code, the City Auditor prepares an annual work plan 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 fourth quarter activities and summarizes our 2008-09 Work Plan activities. Information on the status of each assigned project is attached (pages A-1 through A-6).

#### **Completed Projects**

During 2008-09, the City Auditor's Office issued the following reports to the City Council:

- Annual Audit Work Plan with Risk Assessment (Oct-2008)
- Quarterly progress reports summarizing audit progress, revenue recoveries and accomplishments
- Quarterly summaries on Palo Alto sales and use tax receipts
- Status of Audit Recommendation Follow-Up (December 2008)
- Maze & Associates' Audit of the City of Palo Alto's Financial Statements as of June 30, 2008 and Management Letter (Dec-2008)
- 7<sup>th</sup> Annual Service Efforts and Accomplishments (SEA) Report (Jan-2009)
- Audit of Ambulance Billing and Revenue Collection (Feb-2009)
- External Peer Review (March-2009)
- Council approval for contract contingency with Maze & Associates (May -2009)

In addition, the City Auditor's Office completed the following projects:

- Sales Tax Allocation Reviews (City received \$84,762 in recoveries from our in-house and contracted sales tax audits)
- Accounts Receivable Write-Off of Utilities Billing (City received \$30,000 and continues to service remaining balances)
- Maze & Associates vulnerability and system security testing of the SAP Utilities Module.

*Attachment 1*

- The City Auditor's Office received and followed up on four public inquiries. Three were resolved, one is still in process.
- The City Auditor's Office met with City staff to discuss the accountability elements of the American Recovery and Reinvestment Act (ARRA) funds. As a result, ASD Accounting staff established separate account codes to track ARRA funds within the City's SAP system.

***In-process Projects***

The following projects were in-process as of June 30, 2009:

- Audit of the Police Investigative Fund (Draft issued, Item scheduled for Finance Committee)
- Review of City Telephone Rates and Charges (Draft issued, Item scheduled for Finance Committee)
- Audit of Vehicle Replacement and Maintenance Fund (Report Writing Phase)
- Citywide Cash Handling (Began in March 2009)
- Controls review of SAP Upgrade and Utilities Module Implementation (on-going)
- Issued Request for Proposal and selected consultant to provide expertise in the upcoming Utilities Department audit.
- As part of our continuous revenue monitoring efforts and preliminary findings from the vehicle audit, the Auditor's Office initiated revenue recoveries from the Federal government's alternative fuel tax program.

In addition to the in-process projects already listed, the following projects are anticipated to be carried-over into next year:

- Audit of Purchasing Cards
- Wastewater Treatment Fund
- Prospective Analysis of Bond Measure Proceeds (Measure N)

***Other Pertinent Information***

- As part of the 2010 Proposed Budget Hearings, the Finance Committee requested we ask the external financial auditors, Maze & Associates, to voluntarily forego the contractually built-in CPI adjustment for the FY 2009 audit. We forwarded this request to Maze & Associates, and the company graciously agreed. This would keep the external financial audit basic services cost at \$136,890 instead of \$141,955 (a total of \$5,065 in savings in the 2010 Budget).
- Rochelle Sazegari joined us in June 2009 as a Performance Audit Intern. She is working on the development of our 8<sup>th</sup> Annual SEA Report.

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 throughout this year.

Respectfully submitted,



Lynda Flores Brouchoud  
City Auditor

Attachments:

- Status of Audit Projects as of June 30, 2009

## Status of Audit Projects as of June 30, 2009

Original Audit Project Description and Preliminary Objectives	Status	Accomplishments Year-To-Date	Items to be Completed
<b>AUDIT ADMINISTRATION, FOLLOW-UP, AND OTHER RESPONSIBILITIES</b>			
<p>1) <b>Annual Audit Work Plan and Quarterly Status Reports</b> – 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.</p>	Completed	<p>1<sup>st</sup> Quarterly Report issued Oct 2008.                  2<sup>nd</sup> quarter completed Dec 2008.                  3<sup>rd</sup> quarter completed Mar 2009.                  4<sup>th</sup> quarter completed June 2009.</p>	
<p>2) <b>Annual Audit Recommendation Status Report</b> – 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 the departments involved during the year to discuss progress towards implementing open audit recommendations.</p>	Completed	<p>Report Issued December 2008.                  The report summarized the status of 142 audit recommendations (86 carried over and 56 new recommendations). The report determined that 78 (55%) of the audit recommendations were completed or resolved, 51 (36%) were in-process, and 13 (9%) were not started.</p>	
<p>3) <b>External Peer Review</b> – The external peer review (conducted once every three years) evaluates the quality control of the Auditor’s Office and its compliance with Government Auditing Standards (GAS)</p>	Completed	<p>Peer Review conducted the first week in Feb – 2009. The Peer Review Team issued an unqualified opinion.</p>	
<p>4) <b>Meeting Attendance</b> – To facilitate internal communication and coordination of efforts, the City Auditor attends:</p> <ul style="list-style-type: none"> <li>a. <i>City Manager’s weekly executive leadership team meetings.</i></li> <li>b. <i>Utility Risk Oversight and Coordinating Committee (UROCC)</i> – 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 UROCC.</li> </ul>	<p>On-going  On-going</p>		

Original Audit Project Description and Preliminary Objectives	Status	Accomplishments Year-To-Date	Items to be Completed
<b>REVENUE AUDITS AND MONITORING</b>			
<p>5) <b>Sales and Use Tax Allocation Reviews</b> – Sales and use tax represented about 15%, or \$22 million, of projected General Fund revenue in the City's Adopted Operating Budget for FY 2008-09. In April 2009, a midyear budget adjustment for sales and use tax was made to reflect an expected decline in sales and use tax revenue to \$20.3 million for FY 2008-09.</p> <p>The Auditor's Office contracts with MuniServices for quarterly sales and use tax recovery and information services, and we also conduct sales and use tax monitoring in-house. The purpose of this monitoring is to identify misallocations of local sales and use tax of companies doing business in Palo Alto. In addition, MuniServices prepares the quarterly sales and use tax information reports that are provided to the City Council as informational items.</p> <p>We have renewed the contract with MuniServices for one year. The new contract expires in March 2010, and has an option to renew for one additional year by mutual consent.</p>	<p>On-going</p>	<p>In the first quarter of FY 2008-09, the City received <b>\$36,032</b> in sales and use tax recoveries related to misallocation of tax from 8 companies.</p> <p>In the second quarter of FY 2008-09, the City received <b>\$24,433</b> in sales and use tax recoveries related to misallocation of tax from 8 companies.</p> <p>In the third quarter of FY 2008-09, the City received <b>\$14,931</b> in sales and use tax recoveries related to misallocation of tax from 5 companies.</p> <p>In the fourth quarter of FY 2008-09 the City received <b>\$2,973</b> in sales and use tax recoveries related to the misallocation of tax from one company.</p> <p>During FY 2008-09, the City received an additional <b>\$6,393</b> in recoveries related to new businesses.</p> <p>Moreover, potential misallocations from <b>40 companies</b> (13 MuniServices and 27 City of Palo Alto) are pending resolution by the State Board of Equalization.</p> <p><b>Note:</b> In June 2009, the State Board of Equalization advised us they have a six-month backlog in processing inquiries.</p> <p><b>Total Sales and Use Tax Recoveries:</b>  <b>FY 2008-09 \$84,762</b>  <b>(MuniServices- \$24,094 and the City Auditor's Office - \$60,668)</b></p>	

Original Audit Project Description and Preliminary Objectives	Status	Accomplishments Year-To-Date	Items to be Completed
<b>FINANCIAL AUDITS AND PROCEDURAL REVIEWS</b>			
<p>6) <b>Annual External Financial Audit (contracted audit service)</b> – The City Charter requires that the City Council engage an independent certified public accounting firm to conduct the annual external audit.</p>	<p>Completed</p>	<p>FY 2007-08 Report issued Dec - 2008 for Maze &amp; Associates audit work on the June 30, 2008 financial statements &amp; internal controls.</p> <p>In Mar – 2009 Maze &amp; Associates will begin interim audit work in preparation for the audit of the June 30, 2009 financial statements.</p>	
<p>7) <b>Controls Review of SAP Upgrade and Utilities Module Implementation</b> – The City's SAP upgrade is occurring in two phases – Phase I on Employee Self-Service/Management Self-Service and Phase II on Utilities. Phase I was completed July 2008. The Auditor's Office has reviewed general controls throughout the upgrades.</p>	<p>On-going</p>	<p><b>Update as of the 2<sup>nd</sup> Quarterly Report:</b></p> <p>For the Phase II Utilities module implementation, the Auditor's Office reviewed the initial blue printing and design stages and no issues were raised. The Auditor's Office also reviewed the user testing results and identified best practices in management systems. In December 2008, the Auditor's Office provided feedback to the Utilities Department and ASD regarding the incorporation of user input from integration testing, system security, and contingency planning for the transition from the existing system to the new SAP Utilities module. The SAP managers and steering committee members are currently addressing these areas and the departments met with our Office to discuss these areas. SAP managers, with Council approval, have extended the implementation timeline to June 2009. We will continue to monitor the progress of the SAP project.</p>	<p>Target completion date: Sept - 2009</p>

Original Audit Project Description and Preliminary Objectives	Status	Accomplishments Year-To-Date	Items to be Completed
		<p><b>Update as of the 4<sup>th</sup> Quarterly Report:</b>            In May 2009, the City activated the SAP Phase II Utilities module (referred to as the Utility Billing System CCS). The new system contained customer utility account information for the seven utilities - Gas, Electric, Water, Wastewater, Refuse, Fiber and Storm Drain. In May 2009, the City also conducted a beta test for the system's on-line bill payment feature, designed to process and receive customer utility payments on-line. During the beta testing phase, a double billing incident occurred, which the Utilities Department advised was attributed to human error. The on-line bill payment system is expected to be fully operational by August 2009.</p> <p>Prior to the system activation, the City Auditor's Office worked with ASD and the external financial auditors (Maze &amp; Associates) to conduct network security scans and detailed vulnerability testing of the new system. ASD and the Utilities Department are currently using this information to integrate additional internal controls into the new system. The City Auditor's Office will continue to monitor the progress through final implementation.</p>	
<p>8) <b>Accounts Receivable Write-Off of Utilities Billing</b> – As the Utilities Department implements the SAP Utilities module, the Auditor's Office is evaluating the outstanding accounts receivable balance from the prior system to identify potential recoveries.</p>	<p>Completed</p>	<p>As reported in the second quarterly report, the City referred almost \$372,000 in bad debts to a collection agency. As of March 2009, the City received \$30,000 in collections and continues to service the remaining balance.</p>	

Original Audit Project Description and Preliminary Objectives	Status	Accomplishments Year-To-Date	Items to be Completed
<p>9) <b>Police Investigative Fund (NEW)</b> In accordance with the Police Investigative Fund procedures, the City Auditor will conduct a surprise, external audit of the fund. The fund is used to cover certain costs incurred during investigations.</p>	<p>In process</p>	<p>Draft report issued. Report scheduled to be issued July - 2009</p>	<p>Target completion date: July - 2009</p>
<p><b>PERFORMANCE AUDITS AND SPECIAL PROJECTS</b></p>			
<p>10) <b>Service Efforts and Accomplishments (SEA) Report</b> – This is the 7<sup>th</sup> 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).</p>	<p>Completed</p>	<p>Report issued Jan-2009</p>	
<p>11) <b>Audit of Ambulance Billing and Revenue Collection</b> – The Palo Alto Fire Department responds to almost 4,000 medical/rescue calls and transports from 2,000 to 3,000 individuals annually. The purpose of this review would be to assess the overall efficiency and cost effectiveness of ambulance billing and collections.</p>	<p>Completed</p>	<p>Report issued Feb-2009</p>	
<p>12) <b>Audit of Vehicle Replacement and Maintenance Fund</b> – The purpose of this review is to evaluate the efficiency and effectiveness of fleet and equipment replacement and maintenance operations.</p>	<p>In process</p>	<p>Fieldwork completed, draft report in process.</p>	<p>Target completion date: Fall - 2009</p>
<p>13) <b>Wastewater Treatment Fund</b> – 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 \$20 million, proposed expenditures of \$21 million, a \$45 million five-year capital plan, and 70 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>	<p>Not started</p>		<p>Target completion date: TBD</p>
<p>14) <b>Audit of Purchasing Card Transactions</b> – The purpose of this audit is to determine the adequacy of controls over purchasing card transactions, and to assess compliance with existing guidelines and procedures.</p>	<p>Not started</p>		<p>Target completion date: TBD</p>



Original Audit Project Description and Preliminary Objectives	Status	Accomplishments Year-To-Date	Items to be Completed
<p>15) <b>Citywide Cash Handling (NEW)</b> – On July 7, 2008, the City council voted to have the City Auditor study citywide cash handling and travel reimbursements, oversight procedures, and the City Auditor’s history of audits on cash services.</p>	<p>In process</p>	<p>Preliminary survey phase of the audit completed. Next phase is fieldwork.</p>	<p>Target completion date: TBD</p>
<p>16) <b>Prospective Analysis of Bond Measure Proceeds (NEW)</b> – With the November 2008 voter approval of Measure N, the City will be preparing to issue general obligation bonds to rebuild the Mitchell Park Library and adjacent community center, and renovate the Main and downtown libraries. This audit will prospectively evaluate controls for the use of the bond funds to ensure the funds are used efficiently and in compliance with federal regulations for the use of tax-exempt bond funds.</p>	<p>Not started</p>		<p>Target completion date: TBD</p>
<p>17) <b>Utilities Department (NEW)</b> – Several of the highest risk areas identified in the Citywide Risk Assessment pertain to the Utilities Department. This audit will conduct a preliminary survey of the Utilities Department and develop an audit scope to identify opportunities for improvements in efficiency and effectiveness.</p>	<p>Not started</p>	<p>In preparation for the audit, the Auditor’s Office issued a Request for Proposal to select a consultant to provide utilities expertise during the audit. The Auditor’s Office will be able to begin the audit after the contract is in place.</p>	<p>Target completion date: TBD</p>
<p>18) <b>A Review of Telephone Rates and Charges (NEW)</b> – The purpose of this review is to assess the cost effectiveness of the City’s telephone rate structure and charges.</p>	<p>In process</p>	<p>Draft report issued. Report scheduled to be issued Sept-2009.</p>	<p>Target completion date: Sept-2009</p>



## FINANCE COMMITTEE

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Vice Mayor Morton said that he doesn't know that the Committee needs to approve it.

Ms. Brouchoud said that Staff is recommending that the Finance Committee review and recommend that the Council accept the Audit of the Police Department's Investigative Fund.

**MOTION:** Vice Mayor Morton moved, seconded by Council Member Schmid, that the Finance Committee recommends that the City Council approve the Audit of the Police Department's Investigative Fund.

**MOTION PASSED:** 3-0 Klein absent

### 6. Auditor's Office Quarterly Report as of June 30, 2009.

City Auditor, Lynda Brouchoud said this report represents the wrap up of the last fiscal year. The report details the completed projects that the Auditors Office has completed including audit projects and other projects such as sales tax allocation reviews. Our sales tax monitoring this year uncovered close to \$85,000 in recoveries. This is lower than our target of \$150,000 and is likely a reflection of the current economy. There is also an increase in the backlog of inquiries at the State. Staff is hoping that will clear out in time. The Auditor's office initiated additional recovery efforts this year through the Federal Alternative Fuel Tax program we hope to see the results of those efforts. We also have a number of projects in process. We have a review of telephone charges, and the Vehicle Replacement and Maintenance Fund. Staff has initiated the City Wide Cash Handling Audit as it was a clear priority of the Committee. She pointed out as part of the proposed budget, Staff asked the external Auditor to voluntarily forgo the CPI that was built into their contract, and they have agreed to do so.

Chair Burt thanked Maze and Associates for doing their part to help financially. He said it affirms the efforts of looking for sharing in this cost burden. It's a reasonable approach that Council and Staff should continue to explore.

Council Member Schmid said it's hard to assess the overall impact of the office. That's why an annual review at the Council level is done. In terms of



## FINANCE COMMITTEE

work projects there are classes of products like the annual survey and sales revenue audit that are major reports. Secondly there are audit topics that have been identified which are the longer term projects like cash handling. A third element is the smaller topics that come up like the Police Investigative Fund. It's the Auditors job to allocate the Audit Department resources. There is value in completing those smaller items. To take a quick look at them is helpful at the Council level for allocating resources.

Ms. Brouchoud thanked the Committee for the input. She reminded the Committee that the Audit team is the smallest work group in the City and they are charged with the internal controls of the City. She said that when she was hired in September 2008 there had been a six month long Auditor vacancy, and the key Senior Auditor was preparing to leave. As soon as that replacement was on board in March, he was assigned the cash handling project, so the Auditor's Office did take that priority seriously. The Auditor Staff has limited resources and manages to consistently balance the priorities and deliver quality product. When there are smaller audits to be done, the Staff tends to fill them in between the larger audits to help maintain that work flow.

Council Member Morton said that auditors peer reviews are important to assist the Auditor develop their work plan. The peer review wants to know if they have looked at the range of things. That's the real importance of that peer review is making sure the Auditor isn't just reacting to political pressure. He commended Ms. Brouchoud and her Staff for balancing all of that in the last nine months. He noted that the peer review was amazed that this small Staff meets these professional requirements.

**MOTION:** Council Member Schmid moved, seconded by Council Member Burt that the Finance Committee recommends to the City Council acceptance of the Auditor's Office Quarterly Report as of June 30, 2009.

**MOTION PASSED:** 3-0 Klein absent

### 7. Discussion for Future Meeting Schedules and Agendas

Chair Burt said when Agenda Item Number 4 goes before Council the benefits the City will receive through the tightening of the contract and the incentives should the vendor perform at the higher standard will need to be addressed.