



CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

November 7, 2011

The Honorable City Council
Palo Alto, California

Finance Committee Recommendation to Accept the Auditor's Office Quarterly Report as of June 30, 2011

The City Auditor's Office recommends acceptance of the City Auditor's Quarterly Report as of June 30, 2011. At its meeting on September 20, 2011, the Finance Committee approved and unanimously recommended the City Council accept the Auditor's Office Quarterly Report as of June 30, 2011. The Finance Committee minutes are included in this packet.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Ian Hagerman".

Ian Hagerman
Senior Performance Auditor

ATTACHMENTS:

- Attachment A: Auditor's Office Quarterly Report as of June 30, 2011 (PDF)
- Attachment B: Finance Committee Minutes Excerpt (September 20, 2011) (PDF)

Department Head: Mike Edmonds, Interim City Auditor



CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

September 20, 2011

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

Auditor's Office Quarterly Report as of June 30, 2011

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, 2011.

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 Fiscal Year (FY) 2011 Work Plan activities. Information on the status of each assigned project is attached (pages A-1 through A-6).

Completed Projects

During FY 2011, the City Auditor's Office completed the following reports and projects:

- Developed an implementation plan for an employee-only hotline (Jun-2011)
- Conducted a Request for Proposal (RFP) process to select a firm to conduct the City's external audit for the next five years. The City Council approved the Auditor's recommendation to award the contract to Macias Gini & O'Connell LLP (MGO) for external financial audit services (May-2011)
- Conducted a RFP process to select a firm to provide sales and use tax recovery and information services. MuniServices was selected to provide the needed services and was awarded the contract through 2014 (April 2011)
- Status of Audit Recommendations (Apr-2011)
- 9th Annual Service Efforts and Accomplishments Report for Fiscal Year 2010 (Jan-2011)
- Geographic Subgroup Comparisons from the 2010 National Citizen Survey Results (Jan-2011)
- 2nd Annual Citizen-Centric Report (Jan-2011)

- Maze & Associates' Audit of the City of Palo Alto's Financial Statements as of June 30, 2010 and Management Letter (Dec-2010)
- Status of Audit Recommendations (Oct-2010)
- Audit of Citywide Cash Handling and Travel Expenses (Sep-2010)
- Restatement of Greenhouse Gas Emissions and Energy Savings in City Operations (Jul-2010)
- Annual Audit Work Plan with Risk Assessment (Jul-2010)
- Quarterly summaries on Palo Alto sales and use tax receipts
- Quarterly progress reports summarizing audit progress towards our annual work plan, revenue recoveries and accomplishments

In-process Projects

The following projects are in-process:

- Audit of Library Bond Proceeds
- SAP Security
- Audit of Purchasing Card Transactions
- Utilities Department Risk Assessment
- Employee Benefits

In addition to the in-process projects, the following projects will be carried over into FY 2012:

- Wastewater Treatment Fund
- Planning and Community Development Permit Process (temporarily deferred to provide City Manager and Department time to implement program improvements and coordinate their progress with the audit work).

Confirmed Revenue Savings

In fiscal year 2011, the City Auditor's Office revenue recoveries totaled \$95,625. This total includes sales and use tax recoveries of \$24,014 and alternative fuel tax credit revenues of \$71,611.

Awards

In FY 2011, the Auditor's Office received three national awards for our work. Specifically, the Association of Local Government Auditors awarded their Gold Knighton Award for the Audit of Fleet Utilization and Replacement. The Association of Government Accountants (AGA) awarded their Gold Award for the FY 2010 Service Efforts and Accomplishments Report and their Certificate of Excellence in Citizen-Centric Reporting for Palo Alto's second-annual Citizen-Centric Report. These awards are AGA's highest report distinctions and put Palo Alto in the top cities nationally for transparency and accountability in performance reports.

Community Outreach and Other Information

- The Auditor's Office conducted community outreach on the Service Efforts and Accomplishments (SEA) Report and the Citizen-Centric Report, meeting with the Library Advisory Commission (LAC), City/School Liaison Committee, and the Infrastructure Blue Ribbon Commission (IBRC). We also briefed the IBRC on Auditor's Office reports on infrastructure, cities to contact on infrastructure, and the methodology used to conduct audits.
- In March 2011, Deniz Tunc was hired to replace Patricia Hilaire as the Office's Administrative Assistant.
- In October 2011, the City Council appointed Mike Edmonds as the Acting City Auditor while City Auditor, Lynda Brouchoud, was on maternity leave. In March 2011, Lynda Brouchoud resigned as City Auditor. Mike Edmonds was then named Interim City Auditor and will continue to head the department until a permanent successor is appointed.
- Mimi Nguyen, Senior Performance Auditor, joined the Auditor's Office in September 2010. The City Council approved this position in the FY 2011 Budget to provide continuous and on-going audits of Enterprise Funds.
- Senior Performance Auditor, Houman Boussina, passed the Certified Information Systems Auditor (CISA) examination.
- Senior Performance Auditor, Ian Hagerman, completed the certification process for the Certified Internal Auditor (CIA) and the Certified Fraud Examiner (CFE) certifications.
- In June 2011, the Auditor's Office hired two student interns, Caitlin Buckley and Uyen Mai, to assist in audit work and to learn about auditing.

On behalf of the City Auditor's Office, I would like to express my appreciation to City staff for their cooperation and assistance during our reviews throughout this past year.

Respectfully submitted,



Michael Edmonds
Interim City Auditor

ATTACHMENTS:

- Attachment A: Status of Audit Projects as of June 30, 2011 (PDF)

Department Head: Mike Edmonds, Interim City Auditor

Status of Audit Projects as of June 30, 2011

Audit Project Description and Preliminary Objectives	Status	Accomplishments Year-To-Date	Target date for Items to be Completed
AUDIT ADMINISTRATION, FOLLOW-UP AND OTHER RESPONSIBILITIES			
1) Annual Audit 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.	Completed	Annual work plan issued Jul 2010 First, second, third, and fourth quarterly status reports completed.	
2) Annual 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 the departments involved during the year to discuss progress towards implementing open audit recommendations.	Completed	Report issued October 2010.	
3) Revised Audit Recommendation Status Report- Pursuant to City Council request of Oct 10, 2010 to revamp and reissue Status of Audit Recommendations at midyear	Completed	Report on Status of Audit Recommendations was presented to the Finance Committee on April 19, 2011. The revised report included comments on the current status of recommendations and estimated timeframes to implement the audit recommendations. The report also highlights significant accomplishments since the last reporting period, as well highlighting outstanding recommendations needing the City Council’s attention. Additionally, the report identifies 9 recommendations from the Infrastructure Report Card Audit that can be deferred until the Infrastructure Blue Ribbon Commission completes its work and the City Council acts on the recommendations	

Audit Project Description and Preliminary Objectives	Status	Accomplishments Year-To-Date	Target date for Items to be Completed
<p>4) Meeting Attendance – To facilitate internal communication and coordination of efforts, the City Auditor attends:</p> <ul style="list-style-type: none"> a. City Manager’s weekly Executive Leadership Team, Agenda Planning meetings. b. Utility Risk Oversight and Coordinating Committee (UROCC) – Since issuance of our Assessment of Utility Risk Management Procedures in July 2002, the City Auditor has acted as an advisor to the UROCC. c. Design Team Steering Committee meetings. d. Program Management Office meetings 	<p>On-going</p> <p>On-going</p>	<p>Both the former City Auditor and the Interim City Auditor have regularly attended weekly Executive Leadership Team meetings, Agenda Planning meetings, and UROCC meetings.</p> <p>One of the audit staff is a member of the Design Team Steering Committee which promotes creative problem solving through design thinking and collaboration.</p> <p>Audit staff has developed expertise in SAP security. Accordingly, the Auditor’s Office has recently agreed to participate in Program Management Office meetings to advise staff on implementing audit recommendations from the SAP security audit.</p>	
<p>5) Request for Proposals (RFP) for the External Financial Auditor Contract –</p> <p>The City’s Charter requires the City Council to engage a certified public accounting firm to conduct the City’s annual financial statement audit and also requires the City Auditor to coordinate the audit. The City’s contract with the current external auditor expired after the FY 2010 audit.</p>	<p>Completed</p>	<p>The Auditor’s Office developed an RFP for external financial audit services to commence in May 2011. During the 3rd quarter, the City Auditor’s Office, along with ASD staff, evaluated proposals, selected a firm, and submitted a report to the Finance Committee on April 2011, recommending that the City contract with Macias Gini & O’Connell LLP (MGO) to perform the annual financial audit for a five year period commencing with the FY 2011 financial audit. The Finance Committee approved the Auditor’s Office recommendation. In May, the City Council approved a five year contract with MGO.</p>	

Audit Project Description and Preliminary Objectives	Status	Accomplishments Year-To-Date	Target date for Items to be Completed
REVENUE AUDITS AND MONITORING			
<p>6) Sales and Use Tax Allocation Reviews – Sales and use tax represents about 14%, or \$19.5 million, of the City’s projected General Fund revenue for fiscal year 2011.</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>The contract with MuniServices continues through April 30, 2014.</p>	On-going	<p>In the first quarter of FY 2011, the City received \$6,232 in sales and use tax recoveries related to misallocation of tax from 6 companies.</p> <p>In the second quarter of FY 2011, the City did not receive any sales and use tax recoveries, although there were potential misallocations pending resolution.</p> <p>In the third quarter of FY 2011, the City received \$8,098 in sales and use tax recoveries related to the misallocation of taxes from four companies.</p> <p>In the fourth quarter of FY 2011, the City received \$6,213 in sales and use tax recoveries related to the misallocation of taxes from four companies.</p> <p>During FY 2011, the City received an additional \$3,471 in recoveries related to new businesses.</p> <p>Moreover, potential misallocations from 40 companies (19 MuniServices and 21 City of Palo Alto) are pending resolution by the State Board of Equalization.</p> <p>Total Sales and Use Tax Recoveries: FY 2011 \$24,014 (MuniServices - \$2,229 and the City Auditor’s Office - \$21,785)</p>	
<p>7) Alternative Fuel Tax Credit Recoveries – As part of the Auditor’s Office continuous revenue monitoring efforts and findings from the Audit of Fleet Utilization and Replacement (April 2010), the Auditor’s Office initiated revenue recoveries from the Federal government’s alternative fuel tax program, which was originally in effect through December 31, 2009, and subsequently extended through December 31, 2011.</p>	On-going	<p>The Auditor’s Office worked with ASD, Utilities, and our revenue consultant to prepare and file claims for the alternative fuel tax credit in the amount of \$24,070 for the second half of calendar year 2009 and \$47,541 for all of calendar year 2010. The</p>	

Audit Project Description and Preliminary Objectives	Status	Accomplishments Year-To-Date	Target date for Items to be Completed
		City received payment for the claims totaling \$71,611 in March 2011.	
FINANCIAL AUDITS AND PROCEDURAL REVIEWS			
8) Annual External Financial Audit (contracted audit service) – The City Charter requires that the City Council engage an independent certified public accounting firm to conduct the annual external audit.	Completed	The FY 2010 audited financial statements were issued in December 2010 and the Acting City Auditor and external auditor presented the results of the FY 2010 audit to the Finance Committee on December 21, 2010. Interim audit work was initiated in May 2011 to prepare for the audit of the FY 2011 financial statements.	
9) SAP Account Sampling – The City implemented the SAP system and upgrades to serve as an enterprise management system for a variety of key financial information and transactions including payroll, utility billing and financial transactions. The purpose of these reviews will be to provide continuous monitoring and sampling of accounts within the SAP system to test for internal controls and to identify efficiencies and cost savings.	In process	The Auditor's Office issued a draft audit report concerning SAP security. The draft report has been distributed to ASD for review and comment prior to issuance.	Target completion date: Oct-2011
PERFORMANCE AUDITS AND SPECIAL PROJECTS			
10) Annual Service Efforts and Accomplishments (SEA) Report	Completed	The 9 th annual SEA Report and 2 nd annual Citizen-Centric Report (CCR) and the Geographic Subgroup Comparisons for Fiscal Year 2010 has been issued and was presented to the City Council on January 18, 2011.	
11) Audit of Citywide Cash Handling and Travel Expenses – The purpose of this review is to study Citywide cash handling and travel reimbursement, oversight procedures, and the City Auditor's history of audits on cash services.	Completed	Audit of Citywide Cash Handling and Travel Expenses issued in September 2010.	
12) Audit of Library Bond Proceeds – Through the 2008 voter-approved Measure N, the City issued general obligation bonds to rebuild the Mitchell Park Library and adjacent community center, and renovate the	In process	The Interim City Auditor determined that additional, but limited testing was needed to update the audit report. The additional	Target completion date: Nov-2011

Audit Project Description and Preliminary Objectives	Status	Accomplishments Year-To-Date	Target date for Items to be Completed
Main and Downtown libraries. This audit will evaluate controls for the use of the general obligation bond funds to ensure the funds are used efficiently and in compliance with federal regulations for the use of tax-exempt bond funds.		testing will be completed and the report will be updated by the end of September.	
13) Audit of Purchasing Card Transactions – 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.	In process	The Auditor's Office issued a draft audit report on the administration of the CAL Card program. The draft report has been distributed to ASD for review and comment prior to issuance.	Target completion date: Sep-2011
14) Utilities Department – 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.	In process	Audit initiated Sep-2010. The Auditor's Office has worked with Matrix Consulting to perform a department-wide risk assessment. The risk assessment is complete and will be used in developing a long-term audit work plan of the department. The workplan will be submitted to the Finance Committee along with the Auditor's Office annual workplan in October 2011.	Target completion date: Oct-2011
15) 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 million, and proposed expenditures of \$20 million, this is one of the areas consistently targeted by our annual citywide risk assessment model. The purpose of our audit would be to review the cost-sharing agreements and allocation of charges to partner agencies.	Not started		Target completion date: TBD
16) Planning and Community Environment Development Permit Process – Two of the top ten risk assessment areas pertain to the Development Center Services and Planning and Community Environment Department. In FY 2010, Council requested that the Auditor's Office review the permit process to identify opportunities for efficiency and effectiveness. Simultaneously, the City Manager's Office and the Planning and Community Environment Department also initiated efforts to study the permit process and identify improvements. Because these staff improvements are in-process, the City Manager's Office has requested a temporary deferral of this audit to coordinate the audit work with staff's improvement efforts.	Not started	Audit temporarily deferred to provide the City Manager's Office and the Planning and Community Environment Department time to implement program improvements.	Target completion date: TBD

Audit Project Description and Preliminary Objectives	Status	Accomplishments Year-To-Date	Target date for Items to be Completed
17) Audit of Fleet Purchases – As a result of the April 2010 Audit of Fleet Utilization and Replacement, the Finance Committee recommended that the City Auditor review the City’s fleet purchases to assess whether the City is purchasing appropriately-sized vehicles at the lowest cost.	Not started		
18) Follow-up Recommendation Status on the 2010 Audit of Fleet Utilization and Replacement - As a result of the April 2010 Audit of Fleet Utilization and Replacement, the Finance Committee directed the Public Works Department to return in January 2011 with an assessment of their implementation of the audit recommendations. The Finance Committee directed the City Auditor’s Office to identify any audit recommendations that staff was not adequately implementing.	Completed	Report on Status of Audit Recommendations was presented to the Finance Committee on April 19, 2011. The Auditor’s Office and Public Works staff reviewed the audit recommendations as part of the annual recommendation status report.	
19) Human Resources Employee Benefits – Two of the top ten risk assessment areas pertain to the Human Resources Department and employee benefits. In FY 2011, the projected benefit costs are expected to be approximately \$40 million. This audit would review benefit oversight, costs and administration through the Human Resources Department.	In process	Preliminary survey phase in process	Target completion date: TBD



FINANCE COMMITTEE - EXCERPT

Regular Meeting
September 20, 2011

Chairperson Scharff called the meeting to order at 7:32 p.m. in the Council Conference Room, 250 Hamilton Avenue, Palo Alto, California.

Present: Scharff (Chair), Schmid, Shepherd, Yeh

Absent:

4. Auditor's Office Quarterly Report as of June 30, 2011.

Interim City Auditor, Mike Edmonds announced in accordance with the Municipal Code the City Auditor's office prepared an annual work plan and quarterly reports explaining to the City Council the status and progress of the work plan items. During the 2011 year the City Auditor's Office developed an implementation plan for the employee only hotline, recommended a firm to conduct the annual financial audit for the City, conducted a Request For Proposal (RFP) to select a firm to provide Sales and Use Tax services, and completed the Status of Audit Recommendations. The survey information for the annual Service Efforts and Accomplishments (SEA) Report, Geographic Subgroup Comparison for the 2010 National Citizens Survey Results, and the second annual Citizens Centric Report should be available in the next few weeks. There were currently five audits underway; the purchasing card transactions, SAP Security, Utilities Department risk assessment, audit of library bond proceeds, and the employee benefits. He notified the Committee that the Waste Water Treatment Fund audit had not begun and he requested direction from the Committee on whether the audit should be of a high priority or removed from the work plan. He noted confirmed revenue saving of \$95,625 through sales tax recoveries as well as fuel tax revenues. In addition there were more than 40 pending misallocations that had been reported to the Board of Equalization. The Auditor's office received the Gold Knighton award from the Association of Local Government Auditors', the Gold award from the Association of Government Accountants', and the Certificate of Excellence.

Vice Mayor Yeh acknowledged the full Council had a detailed discussion regarding the use of the library bond proceeds so he asked whether that information was folded into the audit.

Mr. Edmonds clarified at the present time no, that information was not part of the auditor's report. He noted if it was a direction from the Committee or the Council Staff would incorporate the information.

Council Member Shepherd stated the City Attorney's Office had hired someone to review the bid structure. She asked for confirmation that the City Auditor review was to verify the bond dollars were spent on the build as opposed to something else.

Mr. Edmonds stated that was correct.

Council Member Scharff asked why the oversight of the library bond was a City Auditor function.

Mr. Edmonds stated the issue of the change order process was something that could be reviewed by the City Auditor's Office.

Council Member Scharff stated the City Auditor's involvement with something that could potentially go to litigation could possibly compromise the City's position.

Council Member Shepherd stated the part that might be of interest for the City Auditor would be the bid process.

Mr. Edmonds clarified the Auditor's work was currently focused on ensuring the monies were being spent in accordance with the Bond Measures and the internal controls to be sure there was clear direction on what the money could be spent on or used for.

Council Member Shepherd noted an audit did not always uncover flaws.

Mr. Edmonds said Staff's focus was on internal controls and if there were findings that indicated those controls were poor there was a heightened responsibility to locate the potential examples of fraudulent activity.

Vice Mayor Yeh felt the need for an audit in the context of construction was when there was a variance or larger projects in the pipeline.

Mr. Edmonds asked if the Auditor's office had direction from the Finance Committee.

Vice Mayor Yeh stated he was asking what was included in the current library audit and agreed that there was a potential for complications given the task underway with the City Attorney's office.

Mr. Edmonds noted there could be additional discussion on the topic as the work plan was brought forth over the next few weeks.

Council Member Shepherd shared her concerns with Staff requesting a \$3.6 million change order for the project which was received without detailed explanations regarding what the change was for. She asked Staff to provide supporting documentation with all requested change orders. She was concerned that the information being presented to the Advisory Committees was not accurate.

Council Member Scharff stated it was not the position of the Library Bond Oversight Committee (LBOC) to ensure what the bond proceeds were being used for.

Mr. Edmonds clarified the LBOC was monitoring the spending on the projects. He asked if Mr. Perez had information on their role.

Director of Administrative Services, Lalo Perez stated no, Assistant Director, Joe Saccio was familiar with the LBOC.

Council Member Schmid said it was the responsibility of the Finance Committee to ask the question of who was doing what with respect to the projects and if no one was performing the tasks the City needed to be aware of the situation.

Mr. Edmonds proposed an item be included on the work plan and there be discussions to identify the different responsibilities of the different oversight bodies as it related to the library bond. His familiarity was only with the LBOC.

Council Member Schmid said there was a Library Advisory Committee (LAC) although he was unfamiliar with their exact involvement.

Council Member Shepherd understood the LAC was being presented with information but was not instrumental with financial decisions.

Council Member Schmid clarified his question was one of oversight. One of the LBOC's mandates was to be an active citizens Commission. If there was information in the monthly financial reports that could have alerted them there was an issue they could have brought it forward before it became a problem. He asked as a Council what should be done to ensure all of the aspects were overseen.

Mr. Edmonds stated he would include information on the proposed work plan regarding oversight on the library bond projects.

Council Member Scharff recommended the City Auditor speak with the City Attorney and the City Manager prior to adding recommendations to the work plan.

Council Member Shepherd suggested there be a Study Session on the Library Bond projects.

MOTION: Council Member Schmid moved, seconded by Vice Mayor Yeh, that the Finance Committee recommend the City Council accept the Auditor's Office Quarterly Report as of June 30, 2011.

MOTION PASSED: 4-0