



CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

February 15, 2005

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. This report provides the City Council with an update on the activities of the Office as of February 2005.

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

- Informational report on Palo Alto sales tax (January 2005),
- Maze & Associates' Audit of the City of Palo Alto's Financial Statements as of June 30, 2004 and Management Letter (December 2004),
- Service Efforts and Accomplishments 2003-04 (February 2005)

Our revenue audits continue to yield benefits to the General Fund. The City has received **\$130,709** fiscal year-to-date as a result of our in-house and contracted audits (our goal is \$235,000 in audit recoveries for the fiscal year 2004-2005).

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

- Audit of contract contingencies (March 2005)
- Audit of the workers' compensation program (April 2005)
- Audit of cable franchise fees and customer service provisions (TBD)
- Audits of sales, property, documentary transfer tax, 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

Attachments: City Auditor Project Status as of February 2005

City Auditor Project Status as of February 2005

Original Audit Project Description and Preliminary Objectives ¹	Status	Accomplishments Year-To-Date	Items to be Completed
AUDIT ADMINISTRATION AND FOLLOW-UP PROJECTS			
1. Annual Work Plan and Quarterly Status Reports – The City Auditor submits quarterly reports to the City Council outlining project status and progress towards completing the assignments on the annual work plan.	On-going	In Sep-2004, the City Council approved the FY 2004-05 Work Plan. Quarterly status reports issued Nov-2004 and Jan-2005.	Target date for next quarterly status report: Apr-2005
2. Audit Recommendation Status Report – The City Auditor issues an annual report on the status of recommendations from recently completed audits.	Completed	Report issued Sep-2004 summarizing the status of 131 recommendations including 84 new recommendations that were adopted this year and 47 outstanding recommendations after our last status report as of Jun-2003. The next annual status report will be completed in Sep-2005.	
3. Auditor’s Office Triennial Peer Review – Government Auditing Standards (GAS) require audit organizations to have an external peer review at least once every three years. The National Association of Local Government Auditors coordinates a peer review program to help member organizations meet these standards.	Not started	We have tentatively scheduled the peer review for Oct-2005.	Target completion date: Nov-2005
4. Other Responsibilities			
a. <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		
b. <i>Utility Risk Oversight Committee (ROC)</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 ROC.	On-going		
c. <ADDED> Summer intern program	Completed	Hired Kate Murdock, recent UC Berkeley Goldman School of Public Policy graduate, for summer 2004. Kate assisted with our audit of contract contingencies, and has since gotten a full-time position auditing with the City of Sunnyvale. Senior Auditor Renata Falk supervised Kate’s work, and helped coordinate activities for the citywide summer intern program. Also of note, Pablo Federico, our summer intern from 2002, recently was hired as an Audit Manager with the City of San	

¹ Items marked <ADDED> were added subsequent to the adoption of the Auditor’s FY 2004-05 Work Plan in Sep-2004.

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<p>d. <ADDED> Response to Grand Jury Inquiry into Financial and Performance Audits to the County and Cities in the County.</p> <p>e. <ADDED> Provide training for audit staff in the use of Audit Command Language (ACL) software.</p> <p>f. <ADDED> Taxicab permit application review.</p>	<p>Completed</p> <p>Completed</p> <p>Completed</p>	<p>Francisco Controller's Office. Response dated Aug-2004.</p> <p>In Sep-2004, the office coordinated a training session for 12 local government auditors in the use of the software.</p> <p>At the request of the Police Department, we reviewed the financial statements accompanying the application for a taxicab permit.</p>	
REVENUE AUDITS			
<p>5. Sales Tax Audits – Sales tax represents about 15 percent, or \$18 million, of projected General Fund revenue for 2004-05. We contract with HdL Companies for quarterly sales tax audit and information services. We also conduct audits in-house. Both types of audits focus on verifying that Palo Alto is getting the appropriate allocation of local sales tax. Audit results are reported in the Auditor's Office Quarterly Report. Sales tax information reports (provided by HdL) are transmitted to the City Council on a quarterly basis (last one issued Nov 2004).</p>	<p>On-going</p>	<p>HdL Companies prepare quarterly sales tax reports for the City. Report issued Nov- 2004 (regarding second quarter sales Apr-June 2004).</p> <p>In the first quarter FY 2004-05, the City received a total of \$35,687 in sales tax recoveries related to misallocation of tax from 5 Palo Alto companies. This amount is the result of audits conducted by the City Auditor's Office and by HdL Companies. In addition, the City Auditor's office identified 3 potential misallocations from 3 separate companies.</p> <p>In the second quarter 2004-05 the City received a total of \$38,721 in sales tax recoveries related to misallocation of tax from 1 Palo Alto company. This amount results from audits conducted by the City Auditor's Office. In addition, the City Auditor's Office identified possible misallocations from 3 new companies, and is following up with the State Board of Equalization (SBOE) regarding the status of the 3 potential misallocations reported in the first quarter.</p> <p>Sales tax recoveries year-to-date: \$74,408</p>	<p>Audits are on-going</p> <p>Target date for next informational report: Apr-2005</p>

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<p>6. Property Tax Audits – Property tax represents about 12 percent or \$13.6 million of projected General Fund revenue for 2004-05. We contract with HdL Companies for property tax auditing and information services. Audit services are designed to ensure that County assessment data for properties in Palo Alto are current and accurate. Audit results are reported in the Auditor’s Office Quarterly Report.</p>	On-going	<p>In Oct. 2004, HdL Companies conducted a review of unsecured property taxes for fiscal year 2004-05, and identified \$1,867 in recoveries due from three parcels.</p> <p>Property Tax recoveries year-to-date: \$1,867</p>	On-going
<p>7. Documentary Transfer Tax – The documentary transfer tax (approximately \$3 million annually) is a one-time tax that is levied when residential and commercial properties are sold. We contract with HdL Companies to test County data to ensure that transfer taxes are being properly applied and remitted timely.</p>	On-going	<p>During the first quarter, HdL Companies identified \$1,375 in documentary transfer tax due from one missing transaction recorded to the wrong jurisdiction.</p> <p>Documentary Transfer Tax year-to-date: \$1,375</p>	On-going
<p>8. Utility Users Tax (UUT) – UUT is calculated at 5 percent of electricity, gas, water, and telephone service (generating about \$7.4 million annually). We contract with Tax Compliance Services to audit telecommunications companies’ UUT remittances.</p>	In process	<p>Project started in Jul-2002. During FY 2003-04 the City collected \$102,351 as a result of the audits.</p> <p>In the first quarter FY 2004-05 (Jul-04-Oct-04) the City collected an additional \$8,773 as a result of the audits, and filed a lawsuit against one company (Verizon) for failure to remit more than \$2.4 million over the last 10 years.</p> <p>In the second quarter (Nov-2004 through Jan-2005) the City received \$44,286 in payments from 2 telephone companies as a result of these audits. Additionally, about \$61,560 is currently owed and has been turned over for collection. We estimate \$840,694 is potentially owed from 2 companies that have appealed the audit findings.</p> <p>UUT recoveries year-to-date: \$53,059</p>	On-going
<p>9. Audit of Cable Franchise Agreement and Fees – Contracted audit work provided by the Buske Group and funded by the JPA, with franchise fee audit work to be conducted by the City Auditor.</p>	In Process	Comcast has provided documentation as requested. We are in the process of auditing that information.	Target completion date: TBD

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FINANCIAL AUDITS AND PROCEDURAL REVIEWS			
<p>10. 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. Target date for completion of the 6/30/04 audit: Dec-2004.</p> <p>a. <i>RFP for External Financial Audit Services</i> – Maze & Associates has conducted the financial audit for the last 5 years. This fall, we will issue an RFP for audit services.</p>	<p>Completed</p> <p>In Process</p>	<p>Maze and Associates completed their audit work of the financial statements. The Comprehensive Annual Financial Report, related audited financial statements, and Management Letter were issued Dec-2004.</p> <p>RFP issued Jan-2005</p>	<p>Target date: Apr-2005</p>
<p>11. 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. As time allows, we provide requested assistance in these areas and, where possible, help departments develop their own control self-assessment programs. Projects include:</p> <p>a. <i>Controls Review of SAP</i> – The Auditor’s Office will continue to monitor the implementation of SAP and provide advice to ASD on the adequacy of controls in the new system.</p> <p>b. <i>Cash Controls</i> – Pursuant to a request from the Finance Committee last year, the City’s external auditor, Maze and Associates, is reviewing the Golf Professional’s cash handling procedures as part of the annual external audit.</p> <p>c. <i>Audit of the police investigative fund</i> – Pursuant to Police Department procedures, the Auditor’s Office conducts a surprise review on an annual basis.</p>	<p>On going</p> <p>Completed</p> <p>Completed</p>	<p>Additional SAP training and familiarization given to audit team, and potential areas for audit are being identified. We are discussing potential internal control weaknesses with system managers as we go along.</p> <p>Maze and Associates completed their review. Report issued Dec-2004.</p> <p>Audit report issued Nov-2004.</p>	<p>On going</p>
<p>12. 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 include:</p> <p>a. <i>Cost-benefit analysis of library fines</i> – In cooperation with the Library Department, we will assess the cost versus benefit of imposing and collecting library fines. Target start date: TBD (if time permits).</p>	<p>Not started</p>		<p>Target completion date: TBD (if time permits)</p>

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PERFORMANCE AUDITS AND SPECIAL PROJECTS			
<p>13. Review of Environmental Services Center Proposal – The City Auditor has agreed to do a review of the proposal’s assumptions and financial implications, and to provide that information to the City Council in a study session prior to approval of a consultant contract for an Environmental Impact Report for the ESC.</p>	Completed	Report issued Nov 2004.	
<p>14. Audit of Contract Contingencies (in process) – The objective of this audit is to evaluate the appropriateness of contract contingency levels, the approval process for using contingency dollars, and actual contingency usage. Target date: Dec- 2004.</p>	In process	Fieldwork is complete and we are finalizing our draft report.	Target completion date: Mar-2005
<p>15. Service Efforts and Accomplishments (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). Our aim is to provide the City Council, staff, and the public with an independent, impartial assessment of past performance to help make better decisions about the future. Target issuance date: Jan-2005.</p>	Completed	<p>Report issued Feb-2005 including results of second annual citizen survey.</p> <p>In addition, in Sep-2004, audit staff participated in a training session with the Association of Government Accountants, helping to develop guidelines for the nationwide Certificate of Achievement in Service Efforts and Accomplishments Reporting.</p> <p>In Oct-2004, the City Auditor participated in a panel discussion about the uses of citizen surveys at the International City-County Management Association’s annual conference.</p> <p>In Jan-2005, the City Auditor participated in a peer review of the Washington State Department of Transportation’s service efforts and accomplishments report.</p>	
<p>16. Audit of the Workers’ Compensation Program – The purpose of this review is to identify additional opportunities to control claim costs in the face of rising medical costs. Target date: Jan/Feb-2005.</p>	In Process	Fieldwork is in process.	Target completion date: April-2005
<p>17. Community Service Department Review – Our FY 2003-04 audit work plan included an organizational review of the Community Services Department. That project was delayed because of pending retirements and reorganization efforts. Since departmental reorganization is continuing, we propose two smaller projects:</p>			

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<p>a. <i>Analysis of cost-effectiveness of parks maintenance contracting versus staffing.</i> Target start date: Feb-2005.</p> <p>b. <i>Audit of CSD class program revenue/cost recovery</i> – Determine the income/subsidy of class programs net of direct and indirect costs, including staffing. Target start date: Spring-2005.</p>	Not started		Target start date: Spring 2005
	Not started		Target start date: Spring 2005
<p>18. Police property room (carryover project from FY 2003-04) – The Police Department desires an independent audit of the property room. This is also responsive to a 2004 Santa Clara County Grand Jury <i>Inquiry into Police Evidence Rooms in Santa Clara County</i>. Target start date: Feb-2005.</p>	Not started		Target completion date: Spring 2005
<p>19. Streets – The resurfacing and reconstruction of City streets is a major component of the CityWorks program, including estimated 2004-05 General Fund expenditures of \$2 million, and a five-year capital improvement program totaling \$12 million. Our review would include the criteria for prioritizing street repairs, and coordination of subsurface work.</p>	Not started		Target start date: Summer 2005
<p>20. Audit of entrepreneurial programs – The City has a number of “entrepreneurial programs” including IT services, animal control, BLS ambulance service, and training programs. The purpose of this review would be to analyze the net revenue and cost/benefit of <i>one</i> of these programs.</p>	Not started		Target completion date: TBD (if time permits)
<p>21. Wastewater Treatment Fund – Wastewater treatment is a major city program with estimated 2004-05 expenditures of \$20.4 million, a five-year capital program totaling \$24.7 million, and 69 full-time equivalent staff.</p>	Not started		Target completion date: TBD (if time permits)