



## CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

April 10, 2007

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

### **Auditor's Office Quarterly Report as of March 31, 2007**

#### **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 March 31, 2007.

#### **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 March 31, 2007.

We issued the following reports to the City Council since our last status report in January 2007:

- Informational report on Q3-2006 Palo Alto sales tax (Feb-2007)
- Audit of the Palo Alto Sanitation Company Contract (Apr-2007)

Also this quarter:

- The Association of Government Accountants awarded the City of Palo Alto with our third annual Certificate of Excellence in Service Efforts and Accomplishments (SEA).
- The office presented a seminar on performance measurement and SEA reporting to the Bay Area Local Government Auditors.
- On March 27, 2007, the office hosted a delegation of 21 auditors from the People's Republic of China who are in this country studying performance auditing.

Our revenue audits continue to yield benefits to the General Fund. The City has received \$76,576 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 \$62,922 in sales tax, and \$13,654 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):

- Audit of Library operations (May-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-5). 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 March 31, 2007

## Status of Audit Projects as of March 31, 2007

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><b>1. Annual 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>	On-going	<p>In Sep-2006, the Finance Committee recommended approval of the FY 2006-07 work plan. The City Council approved the work plan in Nov-2006.</p> <p>Quarterly reports have been issued as of September 30 and December 31, 2006, and March 31, 2007.</p>	Next quarterly status report: Jul-2007.
<p><b>2. 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 involved departments mid-year to discuss progress towards implementing open audit recommendations.</p>	On-going	<p>The report summarized the status of 143 recommendations including 77 completed, 50 partly implemented, and 16 not started. The Finance and Policy &amp; Services Committees reviewed their respective portions of the report in Nov-2006. At the request of the Finance Committee, the Public Works Department provided additional information on the status of street maintenance audit recommendations to the Committee in Feb-2007.</p>	
<p><b>3. Meeting attendance</b> – 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.</p>	On-going		
<p><b>4. Utility Risk Oversight and Coordinating Committee (UROCC)</b> – 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. Our citywide risk assessment model continues to target the various utility funds including wastewater treatment, electric, water, and wastewater collection.</p>	On-going		

Original Audit Project Description and Preliminary Objectives	Status	Accomplishments Year-To-Date	Items to be Completed
<b>REVENUE AUDITS<sup>1</sup></b>			
<p><b>5. Sales tax allocation reviews</b> (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 audits in-house. Both types of audits focus on verifying that Palo Alto is getting the appropriate allocation of local sales tax.</p>	On-going	<p>MMC continues to provide quarterly sales tax information reports. The report summarizing Q1-2006 sales was distributed in Jul-2006; the report summarizing Q2-2006 sales was distributed in Nov-2006; and the report summarizing Q3-2006 sales was distributed in Feb-2007.</p> <p>In the first quarter of FY 2006-07, the City 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 &amp; Associates (HdL), MMC, and the City Auditor’s Office.</p> <p>In the second quarter of FY 2006-07, the Office followed up on potential misallocations from 14 companies pending resolution by the State Board of Equalization.</p> <p>In the third quarter of FY 2006-07, the City received \$27,903 in sales tax recoveries related to misallocation of tax from 7 companies. This amount is the result of audits conducted earlier by MMC and the City Auditor’s Office. In addition, potential misallocations from 13 companies are pending resolution by the State Board of Equalization.</p> <p>Sales tax recoveries year-to-date: <b>\$62,922</b></p>	<p>Next quarterly sales tax information report: May-2007.</p>

<sup>1</sup> 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
<p><b>6. Transient occupancy tax audit</b> – 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 \$13,654 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: <b>\$13,654</b></p>	
<b>FINANCIAL AUDITS AND PROCEDURAL REVIEWS</b>			
<p><b>7. 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 an annual external audit. This is the second year of a three-year contract with Maze &amp; Associates.</p>	<p>Completed</p> <p>In process</p>	<p>In Dec-2006, Maze &amp; Associates issued an unqualified (clean) audit opinion on the audited financial statements as of June 30, 2006.</p> <p>In Mar-2007, Maze began interim audit work in preparation for the audit of the June 30, 2007 financial statements.</p>	
<p><b>8. Audit of the police investigative fund</b> – Pursuant to Police Department procedures, the Auditor’s Office conducts a surprise review on an annual basis.</p>	Not started		Target date: TBD
<p><b>9. Review of ethics policies</b> – 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.</p>	In process	We are in the fieldwork phase of this review – determining what policies are currently in place and where additions might be needed.	Target date: TBD
<p><b>10. &lt;NEW&gt; Audit of SAP payroll controls</b> – 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.</p>	Not started		Target date: TBD

Original Audit Project Description and Preliminary Objectives	Status	Accomplishments Year-To-Date	Items to be Completed
<b>PERFORMANCE AUDITS AND SPECIAL PROJECTS</b>			
<b>11. Audit of CSD class program cost recovery</b> – 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.	
<b>12. Infrastructure report card</b> – 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
<b>13. Audit of the Waste Management/PASCO contract</b> – 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.	Completed	Report issued Apr-2007. The report includes a total of 19 recommendations to ensure compliance with the financial terms of the contract, and identify improvements for the upcoming request for proposals and contract award after the current contract expires in Sep-2009.	
<b>14. Service Efforts and Accomplishments (SEA) Report</b> – This will be the 5 <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).	Completed	Report issued Dec-2006. The report was presented to the City Council on January 29, 2007.	
<b>15. Audit of Library operations</b> – The purpose of our review is to identify potential operating efficiencies and cost savings.	In process	We are in the fieldwork phase of our review.	Target completion date: May-2007
<b>16. Audit of vehicle replacement and maintenance fund</b> – 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.	Not started		Target date: TBD
<b>17. Police community survey</b> – 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.	Not started		Target date: TBD

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<p><b>18. EMS ambulance transport service billing and revenue collection</b>  – 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><b>19. Public-private partnership reviews</b> – The Auditor’s Office will assist in reviewing the expected proposal from the Friends of the Palo Alto Junior Museum &amp; Zoo (PAJMZ) to operate the PAJMZ, and the proposed analysis of golf course operations.</p>	Not started		Target date: TBD
<p><b>20. 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 \$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