



## CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

July 17, 2007

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

### **Auditor's Office Quarterly Report as of June 30, 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 June 30, 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 June 30, 2007.

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

- Informational report on Q4-2006 Palo Alto sales tax (May-2007)
- Audit of Library operations (July-2007)
- Audit of the Police Investigative Fund (attached)

Also this quarter:

- The Association of Local Government Auditors (ALGA) presented its Bronze Award for best audit in the small audit shop category to our Audit of Street Maintenance. Senior Auditor Edwin Young attended the ALGA national conference in Memphis, Tennessee, and received the award.
- At the invitation of the Association of Government Accountants and the Performance Institute, the City Auditor presented a case study about service levels and reporting in Palo Alto to a forum on "Measuring and Improving Service Levels" in San Diego.

Our revenue audits continue to yield benefits to the General Fund. The City has received \$78,770 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 \$65,118 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.

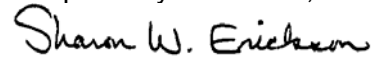
In addition to our on-going assignments, the following projects are in process (with target completion dates):

- Audit of SAP payroll controls (Sep-2007)
- Infrastructure report card (Fall-2007)
- Review of ethics policies (Fall-2007)
- Audit of vehicle maintenance and replacement (Dec-2007)

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  
City Auditor

Attachments:

- Status of Audit Projects as of June 30, 2007
- Audit of Police investigative fund

## Status of Audit Projects as of June 30, 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 and June 30, 2007.</p>	Next quarterly status report: Oct-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>Report issued Nov-2006 summarizing 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. 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 provides quarterly sales tax information reports including the reports summarizing Q1-2006 sales (distributed in Jul-2006), Q2-2006 sales (distributed in Nov-2006), Q3-2006 sales (distributed in Feb-2007), and Q4-2006 sales (distributed May-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.</p> <p>In the fourth quarter of FY 2006-07, the City received \$2,194 in sales tax recoveries related to misallocation of tax from 1 company. This was the result of an audit conducted earlier by MMC. In addition, potential misallocations from 35 companies are pending resolution by the</p>	<p>Next quarterly sales tax information report: Sept-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
		State Board of Equalization. Sales tax recoveries year-to-date: <b>\$65,116</b>	
<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>Target completion date: Dec-2007</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>	Completed	Report attached. No issues found.	
<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 completion date: Fall-2007
<p><b>10. 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>	In process	We completed our fieldwork; staff is reviewing the draft report.	Target completion date: Sep-2007

Original Audit Project Description and Preliminary Objectives	Status	Accomplishments Year-To-Date	Items to be Completed
<b>PERFORMANCE AUDITS AND SPECIAL PROJECTS</b>			
<p><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.</p>	Completed	Report issued Oct-2006. The report included 8 recommendations to address cost recovery. Staff will be proposing a new class cost recovery policy in Sep-2007.	
<p><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.</p>	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: Fall-2007
<p><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.</p>	Completed	Report issued Apr-2007. The report included 19 recommendations to ensure compliance with the financial terms of the contract, and identify potential improvements for the request for proposals and contract award after the current contract expires in Sep-2009.	
<p><b>14. Service Efforts and Accomplishments (SEA) Report</b> – This was 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).</p>	Completed	Report issued Dec-2006. The report was presented to the City Council on January 29, 2007.	
<p><b>15. Audit of Library operations</b> – The purpose of our review was to identify potential operating efficiencies.</p>	Completed	Report issued July-2007. The report includes 32 recommendations to improve Library operations.	
<p><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.</p>	Started	We are in the preliminary survey phase of the audit.	Target completion date: Dec-2007

Original Audit Project Description and Preliminary Objectives	Status	Accomplishments Year-To-Date	Items to be Completed
<p><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.</p>	Not started		Target date: TBD
<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