



CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

April 1, 2003

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 reviews and accepts this 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. The purpose of this report is to provide the City Council with a status report on the activities of the Office as of March 31, 2003.

We issued the following reports to the City Council since our last status report in December 2002:

- **Service Efforts and Accomplishments Report 2001-02** (January 2003) – This was the first annual Service Efforts and Accomplishments report for the City of Palo Alto. The report contains information on the spending, workload, and results of the City's major services. It includes a variety of comparisons to other cities.
- **Audit of Code Enforcement** (March 2003) – We assessed the program's timeliness, responsiveness, and consistency of enforcement. Our report includes a total of 17 recommendations, some of which are already being implemented.

During the quarter, we prepared a memorandum to the City Council recommending approval of the City Manager's Contract Streamlining Recommendations as outlined in CMR:124:03, and distributed an informational report on Palo Alto Sales Tax Receipts for Third Quarter 2002 Sales from our sales tax consultant, HdL Companies. With Finance Committee concurrence, we are negotiating an extension to the agreement with Maze and Associates for external audit services for June 2003 and possibly June 2004.

Our revenue audits are yielding benefits to the General Fund. The City has received \$335,653 in the current fiscal year as a result of our in-house and contracted audits – exceeding our goal of \$235,000 in audit recoveries for the year. This includes \$310,459 in sales tax and \$25,194 in transient occupancy tax. An additional \$11,828 has been

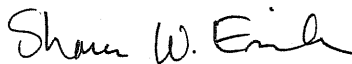
identified for collection (including \$2,101 in property tax, \$7,145 in documentary transfer tax, and \$2,582 in transient occupancy tax).

The following projects are in process:

- Audit of Overtime Usage (started March 2003);
- Audit of the Planning Process (started March 2003);
- Controls Review of the Enterprise Resource Planning System (on-going through January 2004); and
- Audits of sales, property, transient occupancy, and utility users' tax revenues (on-going).

Information on the status of each assigned project is attached (pages A-1 through A-6). In the past I reviewed this information with an ad-hoc Audit Committee. Beginning with this report, I plan to bring this information directly to the Finance Committee. I welcome your comments and suggestions.

Respectfully submitted,



Sharon W. Erickson
City Auditor

Attachments:

A. City Auditor Project Status as of March 31, 2003

City Auditor Project Status as of March 31, 2003

Original Audit Project Description and Preliminary Objectives	Status	Accomplishments Year-To-Date	Items to be Completed
CARRYOVER ASSIGNMENTS			
1. Analysis of the Long Range Financial Plan – The objective of our review is to provide an independent assessment of the feasibility and completeness of the plan. We have provided comments on the Fall-2001 plan to ASD staff, and will prepare an analysis of the Fall-2002 plan for the planned City Council Study Session in October 2002.	Completed	ASD responded to our comments on the 2001 long range financial plan and incorporated a number of our suggestions into the 2002 plan. We provided additional comments to ASD staff on drafts of the 2002 plan, and prepared a memorandum to the City Council summarizing comments (Dec-2002).	
2. Service Efforts and Accomplishments (SEA) Report – The purpose of SEA reporting is to provide consistent, reliable information on the performance of City services that is viewed as credible and objective. We are developing a prototype for an annual report that summarizes workload and results information for the City's major public service areas, and provides benchmark comparisons to comparable jurisdictions.	Completed	Report issued Jan-2003. We plan to issue our next report in Jan-2004.	
3. Performance Audit of Code Enforcement – The objective of this audit is to assess the Code Enforcement Program's timeliness, responsiveness, and consistency of enforcement. This program was last audited in 1997.	Completed	Report issued Mar-2003.	
4. Controls Review of the Enterprise Resource Planning (ERP) System – The implementation of the ERP system over the next 18 months will have dramatic impacts on day-to-day City operations. The City Auditor has been asked to review proposed new work-flows and the accompanying new policies and procedures up-front, rather than after implementation is complete.	In process	The City Auditor is serving as an advisor to the RAFTS Steering Committee. Patricia Hilaire (Administrative Assistant) is serving as liaison to help facilitate RAFTS implementation in the City Auditor's Office, City Clerk's Office, and City Manager's Office.	Target completion date: on-going through Jan-2004.
ON-GOING ASSIGNMENTS AND RESPONSIBILITIES			
5. Annual External Audit – The City Charter requires that the City Council engage an independent certified public accounting firm to conduct an annual external audit. The City Auditor coordinates the annual external audit. Maze & Associates has conducted the audit for the past five years.	Completed	Maze & Associates completed the audit of the June 30, 2002 financial statements, and presented the results to the City Council Finance Committee in Dec-2002, and to the City Council in Jan-2003.	
	In process	In Mar-2003, the Finance Committee agreed that the City Auditor should negotiate a 1-2 year extension to the Maze & Associates contract.	Prepare contract for City Council approval in Apr-2003.

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<p>6. Revenue Audits – The Office contracts with outside vendors to provide the following audit services:</p> <p><i>a. Sales Tax</i> – Sales tax represents about 20 percent or \$21 million of General Fund revenue. We are contracting with HdL Companies for quarterly sales tax audit and information services. Audits focus on verifying that Palo Alto is getting its appropriate share of sales tax allocations.</p> <p><i>b. Property Tax</i> – Property tax represents about 12 percent or \$13 million of General Fund revenue. We are contracting with HdL Property Tax Services for property tax auditing and information services. Audit services are designed to ensure that County assessment data for properties in Palo Alto is current and accurate.</p>	<p>On-going</p>	<p>HdL Companies prepares quarterly sales tax reports for the City. In Oct-2002, we forwarded HdL's informational report on Apr-Jun 2002 sales taxes to the City Council, and in Feb-2003, we forwarded HdL's report on Jul-Sept 2002 sales taxes.</p> <p>HdL Companies also provides sales tax audit services. During the current fiscal year, the City has received \$147,496 in sales tax recoveries resulting from HdL's efforts. These recoveries related to misallocation of tax from 4 Palo Alto companies. HdL's fee is 15% of audit recoveries.</p> <p>MBIA/MRC was our previous sales tax consultant. During the current fiscal year, the City has received \$25,843 resulting from previous MRC audits. These recoveries related to misallocation of tax from 7 Palo Alto companies. MRC's fee is 25% of audit recoveries.</p> <p>During the current fiscal year, the City has also received a total of \$137,120 as a result of audits conducted by the City Auditor's Office. These recoveries related to misallocation of tax from 4 Palo Alto companies.</p> <p>Total recoveries fiscal year-to-date: \$310,459.</p> <p>In Nov-2002, HdL provided information on 2002-03 property taxes. HdL identified \$2,101 in property taxes that were misallocated to other jurisdictions. HdL submitted their findings to the County, and we are waiting for confirmation from the County that the tax has been reallocated. HdL's fee is 15% of audit recoveries.</p>	<p>We expect to receive HdL's next report on sales taxes (for 4th quarter 2002) in April 2003.</p> <p>In Dec-2002, the SBOE took \$543,067 in sales tax from Palo Alto as the result of an SBOE audit of a Palo Alto company. Working closely with ASD and HdL, we are following up on the reasonableness of the SBOE action. The Dec-2002 adjustment related to taxes paid between October 1, 1995 and September 30, 1998.</p>

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<p>c. <i>Documentary Transfer Tax</i> – The documentary transfer tax (approximately \$3 million annually) is a one-time tax that is levied when residential and commercial properties are sold. We have contracted with HdL Coren & Cone to test County data to ensure that transfer taxes are being properly applied and remitted timely.</p>	On-going	<p>HdL conducted a review of documentary transfer tax revenue from Jul-2000 through Jun-2002 and identified \$7,145 in tax that was not collected for 3 property transactions. HdL submitted their findings to the County, and we are waiting for confirmation from the County that the tax has been collected and remitted to the City. HdL's fee is 15% of audit recoveries.</p>	On-going
<p>d. <i>Transient Occupancy Taxes (TOT)</i> – Hotels collect and remit about \$7 million per year in TOT revenue to the General Fund. Tax Compliance Services has completed fieldwork on all 29 hotels, finding a high degree of compliance. Audit results will be available shortly.</p>	Completed	<p>We determined that 11 of the 29 hotels owed small amounts of TOT. We have received a total of \$25,194 in TOT audit recoveries during the current fiscal year, with an additional \$2,582 still owed. This represents a very high degree of compliance on the part of Palo Alto's 29 hotels. The cost of the audits was \$27,500. It would be desirable to re-audit TOT revenues every 3 years.</p>	
<p>e. <i>Utility Users Tax (UUT)</i> – UUT is calculated at 5 percent of electricity, gas, water, and telephone service (generating about \$7 million annually). We have contracted with Tax Compliance Services to audit telecommunications companies' UUT remittances.</p>	In process	<p>On July 30, 2002, we contacted and requested information from the 210 telephone service providers who have remitted UUT payments to the City of Palo Alto. On October 30, 2002, we sent out reminders to those providers who had not yet provided documentation to substantiate their UUT payments. We are working with the City Attorney's Office to determine the best way to obtain documentation from the remaining providers.</p>	Target completion date: Dec-2003.
<p>7. 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 this year include:</p> <p>a. Infrastructure Contract Streamlining Committee – The Office issued a report on contract processing times in April 2002. The City Auditor will provide advice to the Committee as needed regarding proposed changes to contracting procedures.</p>	In process	<p>We are continuing to advise the Committee as they formulate recommendations. In Feb-2003, we prepared a memorandum to the City Council recommending approval of the City Manager's contract streamlining recommendations as outlined in CMF:124:03.</p>	<p>Once changes have been in place for approximately 6 months, we will review how much processing times have improved. Target completion date: TBD.</p>

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<p>b. Reviewing the City's write-off policy for NSF (not sufficient funds) checks less than \$25 (carryover project from 2001-02).</p>	Not started		Target completion date: Jun-2003.
<p>8. 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 will provide requested assistance in these areas and, where possible, help departments develop their own control self-assessment programs. Projects this year include:</p> <p>a. Verifying that the Golf Professional's procedures for handling golf course receipts conform to City procedures (carryover project from 2001-02).</p>	Not started		Target completion date: TBD.
<p>b. <ADDED> Review proposed document destruction list for conformance with the City's Records and Information Management Program Policy and Guidelines.</p>	On-going	The City Clerk periodically purges obsolete City records. The City's procedure requires the City Manager, City Auditor, and City Attorney to review the list of records that are slated for destruction. In Jan-2003, we reviewed a proposed list of records to ensure conformity with departmental retention schedules.	
<p>9. Other Responsibilities:</p> <p>a. <i>Audit Recommendation Status</i> – The City Auditor issues an annual report on the status of recommendations from recently completed audits.</p>	Completed	Report on the status of audit recommendations was issued Sep-2002 and reviewed by the Finance Committee in Oct-2002 and the Policy & Services Committee in Nov-2002.	
<p>b. <i>Annual Work Plan and Quarterly Status Reports</i> – The City Auditor submits quarterly reports to the City Council outlining project status and progress towards completing the assignments on this annual work plan.</p>	On-going	In Aug-2002, the City Council approved the 2002-03 Work Plan. The ad-hoc Audit Committee reviewed the Quarterly Status Report as of Dec-2002 and forwarded the report to the City Council.	Additional status report to be provided Jun/Jul-2003.
<p>c. <i>Executive Staff</i> – To facilitate communication and coordination of efforts, the City Auditor attends the City Manager's weekly executive staff meetings.</p>	On-going		
<p>d. <i>Utility Risk Oversight Committee (HOC)</i> – As a consequence of our recent Assessment of Utility Risk Management Procedures (report issued July 2002), the City Auditor acts as an advisor to the HOC to facilitate implementation of the audit recommendations.</p>	On-going		

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e. <ADDED> Review of Taxicab Application – The Municipal Code requires applicants for taxicab certification to prove they have sufficient assets to properly conduct their business. The City Auditor's Office has historically conducted the financial review.	Completed	On October 7, 2002, the Police Department received a new application for certification. At the request of the Police Department, we reviewed the applicant's financial records and provided comments to the Police Department on the applicant's financial condition.	
f. <ADDED> Comments on the Proposed Contract with the City of Sunnyvale to Provide Animal Sheltering and Associated Services – At the request of the City Manager we reviewed staff's proposal to provide services to the City of Sunnyvale.	Completed	We reviewed staff's proposal and assumptions for reasonableness and completeness, and provided feedback as staff drafted the proposal. We prepared a memorandum to the City Council Dec-2002.	

NEW ASSIGNMENTS FOR 2002-03

10. Performance Audit of the Planning Division – The objective of this audit is to evaluate the efficiency and effectiveness of the Planning Division's handling of proposed development projects.	In process	Pursuant to discussions with the Mayor's ad-hoc committee on the economic base, the City Manager, the Planning Director, and several businesses, we are focusing our audit on the planning process <i>from the customer's viewpoint</i> . We will be flowcharting the development and construction review process from that perspective, and assessing the consistency and timeliness of various reviews.	Revised target completion date: Aug/Sep-2003.
11. Audit of Overtime Usage – The purpose of this audit is to review actual overtime usage and identify opportunities to better control overtime expenditures. Citywide overtime expenditures in 2001-02 were nearly \$4.5 million, including \$3.1 million in the General Fund.	In process	We have completed a preliminary survey and risk assessment of this area, and are beginning the fieldwork phase of our audit.	Target completion date: Jun-2003.
12. Audit of Cable Franchise Customer Service Provisions (contracted audit service to be funded by the joint powers authority) – This audit would provide independent verification of customer service reporting to ensure compliance with provisions in the Municipal Code and franchise agreement standards.	Not started	ASD anticipates receiving the 2002 customer service report from AT&T (now Comcast) in early April. At that time, we will discuss next steps for initiating an audit.	Target completion date: Jun-2003.
13. Customer Satisfaction Survey – The 2001-02 service efforts and accomplishments report (issued Jan-2003) summarized workload and results for major City services, and provided benchmark comparisons to comparable jurisdictions. Customer satisfaction is another key measure of success. The purpose of the survey is to provide baseline information about customer satisfaction on core City services. In the future this information could be included in the annual Service Efforts and Accomplishments report.	Not started	We are planning to conduct a written, statistically valid community survey based on the ICMA/SEA model. We will prepare and conduct the survey as part of our 2002-03 Service Efforts and Accomplishments report.	Target completion date: Jan-2004.

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<p>14. Review of the Workers' Compensation Program – The City has been self-insured for Workers' Compensation since 1979. The City paid about \$370,000 in claim costs in 2000-01, and had an estimated liability of about \$6.2 million for Workers' Compensation claims as of June 30, 2001. The estimated costs per \$100 of payroll have grown from \$1.70 in 1990-91 to \$3.35 in 2001-02. The purpose of this review is to identify additional opportunities to control claim costs in the face of rising medical costs.</p>	Not started		Target completion date: Fall-2003.
<p>15. Audit of Contract Contingency Fees – The objective of this audit is to evaluate (1) the appropriateness of contingency fee levels, (2) the approval process for the use of contingency fees, and (3) actual contingency fee usage.</p>	Not started		Target completion date: Fall-2003.