



## **CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR**

# 08

**The Honorable City Council  
Palo Alto, California**

**April 1, 2002**

### **Auditor's Office Quarterly Report**

The Audit Committee and the City Auditor's Office recommends the City Council review and accept this quarterly report.

#### **Introduction**

The mission of the City Auditor's Office (Office) is to promote honest, efficient, effective and fully accountable City government. To fulfill this mission, the Office conducts audits and examinations of City departments, programs, and services. The purpose of these audits and examinations is to provide the City Council and City management with information and evaluations regarding the effectiveness and efficiency with which City resources are employed, the adequacy of the system of internal controls, and compliance with City policies and procedures and regulatory requirements.

In accordance with the Municipal Code, the City Auditor prepares an annual plan for the City Council's approval, and issues quarterly reports to the City Council describing the status and progress towards completing the audits on the annual plan. The purpose of this report is to provide the City Council with a status report on the activities of the Office during the past three months.

#### **Summary of Results**

We issued two reports to the City Council since our last status report in December 2001:

- **Maze & Associates' Audit of the City of Palo Alto's Financial Statements as of June 30, 2001 and Management Letter** (December 2001) – In addition to the Independent Auditor's Report and the Single Audit Report that were included in the Comprehensive Annual Financial Report, we forwarded six other financial reports from our external auditors to the Finance Committee for their review.
- **Quarterly Sales Tax Audit Recoveries** (February 2002) – The combined efforts of the City Auditor's Office and our outside sales tax auditors resulted in recoveries of \$161,294. Total recoveries for the fiscal year to date are \$218,422. This exceeds our goal of \$150,000 in audit recoveries for 2001-02.

We are strengthening our revenue audit program through the selection of Hinderliter, de Llamas and Associates (HdL) companies as sales and property tax auditors, and Tax Compliance Services as

transient occupancy and utility users' tax auditors. A resolution authorizing HdL to examine confidential sales and use tax records is on the City Council's April 1<sup>st</sup> agenda.

We are recommending the City Council retain the firm of Maze and Associates as our external auditors for the financial statements of June 30, 2002. That item is also on the April 1<sup>st</sup> City Council agenda.

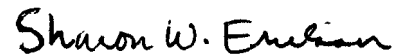
The following assignments are nearing completion:

- Study of infrastructure contract processing times;
- Assessment of utility risk management procedures; and an
- Analysis of the long-range financial plan.

After we complete these projects, the next items on our list are the Service Efforts and Accomplishments benchmarking project and the audit of code enforcement. Additional information on the status of each assigned project is attached (pages A-1 through A-4).

I have reviewed this information with the ad-hoc Audit Committee (Councilmembers Beecham, Freeman, and Morton), and will continue to meet with them on a quarterly basis to monitor the status of current and future projects. Notes from our discussion about the role of the Audit Committee are attached (page B-1). With the concurrence of the rest of the City Council, the Audit Committee and City Auditor will follow the recommended reporting process outlined in those notes.

Respectfully submitted,



Sharon W. Erickson  
City Auditor

Attachments:

- A. City Auditor Project Status as of March 31, 2002
- B. Notes from discussion about Audit Committee role

## City Auditor Project Status as of March 31, 2002

Audit Project and Preliminary Objectives	Status	Accomplishments Year-To-Date	Items to be Completed
<b>ADMINISTRATIVE ITEMS</b>			
<p>1. <b>Auditor's Office General and Administrative</b> – Several improvements in the audit approval, planning and oversight process will be implemented. We will revise quality control procedures as necessary to ensure compliance with the National Association of Local Government Auditors' Peer Review Standards. Detailed audit programs will clearly define work to be performed, and records will be improved with respect to audit project tracking and audit work performed. Other important tasks include filling our vacant audit position, preparing staff performance evaluations, and updating the City Auditor's web page. To facilitate communication and coordination with Council Appointed Officials and staff, the City Auditor will attend weekly executive staff meetings.</p>	On-going	<p>Edwin Young, Senior Auditor, started work in Nov-2001. Edwin brings more than 25 years of audit experience in a variety of government environments.</p> <p>We revised the City Auditor procedures manual, and instituted new audit-tracking and time-reporting procedures. Staff performance evaluations updated Dec-2001.</p> <p>The City Auditor regularly attends City Council, Finance Committee, Executive Staff, and Utilities Advisory Commission meetings.</p> <p>In August, we moved to new offices on the 7<sup>th</sup> floor (space vacated by the City Attorney).</p>	<p>Update the City Auditor's web page by Jun-2002.</p> <p>Conduct interviews to fill the senior auditor position vacated by Phillip Bruni.</p>
<p>2. <b>Annual Audit Plan and Quarterly Status Reports</b> – The City Auditor will submit quarterly reports to the City Council describing our status and progress towards completing the assignments on this annual plan. Beginning in Spring 2002, the Auditor's Office will implement a <b>risk assessment model</b> (a "key plan" item in the 2001-03 Adopted Budget) to prepare the 2002-03 annual audit plan. We will also develop an <b>annual report</b> that identifies the outcomes/accomplishments that result from internal audit efforts (a "key plan" item from the 2001-03 Adopted Budget).</p>	On-going	<p>Annual Audit Plan submitted to City Council and approved Sep-2001.</p> <p>Status reports submitted to the City Council: Aug-2001, Dec-2001, and Mar-2001.</p>	<p>Fourth quarter/annual report to the Finance Committee in Jun-2002.</p> <p>Proposed 2002-03 Audit Plan to be submitted for Council approval in Jul-2002.</p>
<p>3. <b>Audit Recommendation Status</b> – The Municipal Code requires that the City Auditor issues an annual report on the status of recommendations from recently completed audits. This Fall we will report to the City Council on the implementation status of recommendations that were outstanding as of the City Auditor's last audit recommendation status report to the City Council. The report will list those recommendations that have been implemented, those that should be modified or dropped, and will provide an agreed course of action to implement remaining recommendations.</p>	Completed	<p>Report issued Nov-2001 covering the status of 132 recommendations from 15 different audit reports. The next annual review will be completed Summer/Fall 2002.</p>	

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<b>ON-GOING ASSIGNMENTS</b>			
<p>4. <b>Annual External Audit</b> – 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. During 2001-02, this will include:</p> <ul style="list-style-type: none"> <li>• Participating in audit progress meetings and GASB 34 implementation planning sessions;</li> <li>• Conducting a post audit survey of City management and staff to evaluate the performance of the external audit firm (a “key plan” item from the 2001-03 Adopted Budget); and</li> <li>• Contracting for the June 30, 2002 audit of the City’s financial statements.</li> </ul>	On-going	<p>Maze and Associates completed their audit of the City’s June 30, 2001 financial statements, and presented those statements to the Finance Committee in Dec-2001.</p> <p>We conducted a post audit survey of City management and staff in Jan-2002, and recommended that the City Council retain Maze and Associates for the audit of the June 30, 2002 financial statements.</p>	
<p>5. <b>Quarterly Sales Tax Reviews</b> – Sales tax is the City’s largest revenue source, representing about 20 percent or \$25.6 million of total 2001-02 General Fund revenues. The City contracts with MBIA MuniServices Company/Municipal Resource Consultants (MMC/MRC) for sales tax information (on a fee-for-service basis) and sales tax allocation reviews (on a contingency-fee basis). Under the current agreement, the Auditor’s Office conducts the first review of sales tax accounts and MMC/MRC conducts a second review. The agreement with MMC/MRC for sales tax allocation reviews expired December 31, 2001. Depending on the cost/benefit of any new agreement, we will consider contracting the entire sales tax allocation review to an outside vendor.</p>	On-going	<p>Sales Tax Review 2<sup>nd</sup> and 3<sup>rd</sup> Quarters 2000 (issued Aug-2001) identified \$19,591 in misallocated revenue related to two businesses.</p> <p>Sales Tax Review 4<sup>th</sup> Quarter 2000 (issued Oct-2001) identified \$57,128 in misallocated revenue related to two other businesses.</p> <p>Sales Tax Audit Recovery Report issued Feb-2002 identified \$161,294 in recoveries. Total recoveries fiscal year to date are \$218,422.</p> <p>Selected HdL corporation as our new sales tax audit consultant, and prepared a resolution for Council approval authorizing HdL to access sales and use tax records.</p>	Progress report on revenue audit recoveries to be presented to the Finance Committee in Jun-2002.
<b>NEW ASSIGNMENTS</b>			
<p>6. <b>Contracted Revenue Audit Services</b> – Several of the City’s major revenue sources have not been audited in some time. Because of limited in-house resources, we propose contracting for revenue audit services this year. There are several vendors who specialize in conducting revenue audits on a contingency-fee basis. The Auditor’s Office will prepare an RFP to assess interest in conducting the following audits (in addition to the quarterly sales tax reviews mentioned above). Revenue audit areas include: property tax, documentary transfer tax, transient occupancy taxes, and utility users tax.</p>	On-going	<p>We issued a request for proposal in Nov-2001 for contracted audit services. We formed an internal team of members from the Auditor’s Office, Economic Resources, and ASD to review the proposals. We selected HdL companies for sales and property tax audits and reporting services, and Tax Compliance Services for TOT and UUT audits.</p>	Progress report on revenue audit recoveries to be presented to the Finance Committee in Jun-2002.

Audit Project and Preliminary Objectives	Status	Accomplishments Year-To-Date	Items to be Completed
<p>7. <b>Study of Infrastructure Contract Processing Times</b> – The City Manager's Office has initiated a CityWorks Contract Streamlining project team to improve the timeliness of infrastructure-related contract processing. The Auditor's Office will assist the team by flowcharting the contract approval process, reviewing a sample of contracts to document bottlenecks that effect timeliness, and performing a critical path analysis to assess opportunities for improvement. This may include benchmarking against private industry.</p>	In Process	<p>We completed our fieldwork and have issued a preliminary draft report to the Streamlining Team for their comments. We will allow time for management review and comments before bringing this study forward to the Council.</p>	<p>Target completion date: Apr/May-2002 to the Policy and Services Committee.</p> <p>The City Auditor will continue as a member of the Team.</p>
<p>8. <b>Assessment of Utility Risk Management Procedures</b> – As a consequence of changes to the utility industry and the volatility of energy markets, the City is in a position where business risks are much different than under historical operations. The Utilities Department has engaged several experts to advise the City in this area, and has implemented risk management procedures related to the purchase and sale of commodities – a significant source of our current risk. The focus of our review will be on assessing the adequacy of Utility risk management procedures, the appropriateness of designated scopes of authority and levels of management oversight, and the adequacy of management reporting.</p>	In Process	<p>Audit fieldwork is complete. We have discussed audit issues with management, are discussing recommendations, and plan to issue a preliminary draft report to management by the end of March. We will allow time for their review and comment before bringing the report forward to the City Council.</p>	<p>Target completion date: May/June-2002 to the Utilities Advisory Commission and Finance Committee.</p>
<p>9. <b>Independent Analysis of the Long Range Financial Plan</b> – The City Manager will be presenting an update to the long-range financial plan this fall. The City Auditor has been asked to provide an independent assessment of the feasibility and completeness of the plan.</p>	In Process	<p>Audit fieldwork is in process to test the forecasting model, revenue and expenditure assumptions, and the completeness of information about the City's long-term financial commitments.</p>	<p>Target completion date: Spring-2002 to the Finance Committee.</p>
<p>10. <b>Service Efforts and Accomplishments (SEA) Report</b> – 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 will develop 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. The success of the project will depend on cooperation and mutual assistance between audit staff and other City staff in utilizing existing data and management information where possible, limiting reporting to the largest and most visible services, and using a few well-selected indicators that are reliable and valid.</p>	Not Started	<p>We plan to begin this project as soon as the Contract Streamlining (#8 above) and Long Range Financial Plan (#10 above) projects are completed. We plan to use the services of a Stanford student intern to complete this project.</p>	<p>Target completion date: Summer-2002 to the Finance Committee.</p>
<p>11. <b>Audit of Code Enforcement</b> – 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.</p>	Not Started	<p>We plan to begin this project once the Utilities Risk Management Review (#9 above) is completed. Last summer, during our review of the status of open audit recommendations, code enforcement staff</p>	<p>Target completion date: Summer-2002 to the Policy and Services Committee.</p>

Audit Project and Preliminary Objectives	Status	Accomplishments Year-To-Date	Items to be Completed
		provided updated information showing significant improvements in the timeliness of enforcement. We will verify this information during our upcoming review.	
<p>12. <b>Controls Review of the Proposed Enterprise Resource Planning (ERP) System</b> – The City Auditor has been asked to participate in selected ERP team meetings in preparation for (1) reviewing the process maps that will be used to establish ERP system requirements, and (2) conducting a system controls review prior to installation.</p>	Not Started		Target completion date: TBD.
<p>13. <b>Other Bureaucracy Buster Initiatives</b> – The Auditor's Office has been asked to participate in several short projects to (1) independently assess the cost/benefit of streamlining projects, and (2) provide advice on the adequacy of streamlined controls and procedures. We will attempt to provide advice and assistance with these projects as time allows. Proposed projects include:</p> <ul style="list-style-type: none"> <li>• Reviewing the City's write-off policy for NSF (not sufficient funds) checks less than \$25.</li> </ul>	Not started		Target completion date: TBD.
<p>14. <b>Other Reviews of Financial Procedures and Controls</b> – Staff has asked the Office to provide advice on several other procedural and control issues. Where possible, our approach will be to help departments develop their own control self-assessment programs (a "key plan" item from the 2001-02 Adopted Budget). We will attempt to provide requested assistance in these areas as time allows. Proposed reviews include:</p> <ul style="list-style-type: none"> <li>• Verifying that the Golf Professional's procedures for handling golf course receipts conform to City procedures.</li> </ul>	On-going	Upon request, we are available to City staff for advice on procedural and control issues. Items we have addressed so far include advice on employee use of city discounts, record keeping for management benefits, and revisions to the City's gift policy.	Target completion date: TBD.
<p>15. <b>ADDITIONAL ITEM</b> (added by Finance Committee 11/20/01): <b>Review of City Manager's Proposals to Strengthen the Bottom Line.</b></p>	Completed	At the request of the Finance Committee, the City Auditor reviewed and commented on the City Manager's Bottom Line Proposals at the Finance Committee meeting of December 4, 2001.	

## NOTES FROM DISCUSSION ABOUT AD-HOC AUDIT COMMITTEE ROLE

Council Members Bern Beecham, Hillary Freeman, and Jack Morton  
and City Auditor Sharon Erickson  
March 18<sup>th</sup>, 2002

### General

- Assume Finance Committee (as a public, standing committee of the City Council) has financial oversight responsibilities.
- Assume ad-hoc audit committee role is to facilitate and coordinate relationships between Council, City Auditor, City Manager, and external auditor
- The ad-hoc Audit Committee is appointed by the Mayor, and should include at least one member of the Finance Committee and one member of the Policy & Services Committee.

### Specific

- Input and prioritization of audit topics for proposed audit work plan
- Review and recommend external auditor (e.g. participate in RFP when applicable)
- Review and recommend auditor's office budget
- Assign performance audit reports to appropriate standing committee
- As necessary, facilitate audit work (e.g. difficulty obtaining information necessary to complete audit work assigned)
- As necessary, ensure appropriate action on audit findings

### Reporting

	Audit Committee	Finance Committee	Policy and Services	City Council
Annual Audit Plan	✓			Report of officials
External auditor selection and contract	✓			Consent item
Quarterly Status Report	✓			Consent item
Annual Financial Statements		✓		Consent item
Revenue Audit Reports		✓		In packet as information
Performance Audit Reports		✓ or	✓	In packet as information
Annual Recommendation Status Report		✓ or	✓	In packet as information