



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

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

**December 4, 2001**

### **Auditor's Office 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 three reports to the City Council since our last status report in August 2001:

- **Auditor's Office Annual Plan for 2001-02** (September 2001). The annual plan includes three administrative items, two on-going assignments, and nine new assignments. A summary of the status of each of those projects is attached.
- **Quarterly Sales Tax Review** (October 2001) – The Office completed its review of the State Board of Equalization's allocations of sale tax remittances for the 4<sup>th</sup> quarter 2000. The purpose of the review is to ensure that the City is receiving the proper allocation of sales tax. Recoveries result from underpayments and misallocations. Total recoveries for this period were \$57,128.
- **Status of Audit Recommendations** (November 2001) – Based on interviews with City staff, we updated the status of 132 recommendations from 15 different audit reports. We determined that City staff have completed or resolved 100 out of 132 recommendations, or 76 percent. We dropped 3 recommendations. The remaining 29 recommendations are in process. Staff expects to complete most of these recommendations during the current fiscal year.

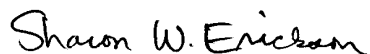
We also initiated the following assignments:

- Review of the timeliness of infrastructure contract processing;
- Analysis of the long-range financial plan;

- Assessment of utility risk management procedures;
- Sales tax review 1<sup>st</sup> and 2<sup>nd</sup> quarters 2001; and
- Additional contracted revenue audit services.

Our audit team is in place. In November, we were pleased to welcome Edwin Young to our team as a Senior Auditor. Edwin brings more than 25 years of audit experience in a variety of government environments. We were also fortunate to be able to bring back Lisa Wehara, who previously worked as a Senior Auditor in our Office, to assist with revenue and sales tax audits on a temporary, part-time basis. In addition, we revised our internal audit procedure manual, and instituted new audit-tracking and time-reporting procedures. Additional information on the status of each assigned project is attached.

Respectfully submitted,

A handwritten signature in cursive script that reads "Sharon W. Erickson".

Sharon W. Erickson  
City Auditor

Attachment

## City Auditor Annual Plan Status Report December 2001

Audit Project and Preliminary Objectives	Status	Accomplishments	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>	In Process	<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 have revised the City Auditor procedures manual, and instituted new audit-tracking and time-reporting procedures.</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>Prepare staff performance evaluations by Dec-2001.</p> <p>Update the City Auditor's web page by Jun-2002.</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 and Dec-2001.</p>	<p>Next quarterly status report to be submitted to the City Council in Mar-2002.</p> <p>Annual report to be submitted to the City Council in Jun-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>	In Process	<p>Our external audit firm, Maze &amp; Associates, has completed the fieldwork phase of their audit of the June 30, 2001 financial statements. Draft statements are being reviewed with staff.</p>	<p>Audited financial statements to be presented to the Finance Committee in Dec-2001.</p> <p>We will conduct a post audit survey of City management and staff in Jan-2002.</p> <p>We will begin reviewing contract terms for the audit of the June 30, 2002 financial statements in Feb-2002.</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 expires 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>	In Process	<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>In Nov-2001, Lisa Wehara, who previously worked as a Senior Auditor in our Office, returned to the Office on a temporary, part-time basis to assist with revenue audits including sales tax.</p>	<p>Sales Tax Review 1<sup>st</sup> Quarter 2001 in process. Target completion date: Jan-2002.</p> <p>Sales Tax Review 2<sup>nd</sup> Quarter 2001 in process. Target completion date: Mar-2002.</p>
<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>	In Process	<p>We issued a request for proposal in Nov-2001 for contracted audit services beginning Jan-2002. Where feasible, we will also use existing and temporary staff to cover these revenue audit areas.</p>	On-going
<p>7. <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</p>	In Process	<p>Preliminary survey work is in process.</p>	<p>Target completion date: Mar-2002.</p>

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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.			
8. <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.	In Process	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.	Target completion date: Jan/Feb-2002.
9. <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.	Not Started	We plan to begin this project in Feb/Mar-2002.	Target completion date: May/June-2002.
10. <b>Review of the Timeliness of Infrastructure Contract Processing</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.	In Process	We have flowcharted the six major phases of the infrastructure contracting process starting with the request for proposals and invitation to bid processes. We are currently sampling various types of capital projects to document the timeliness of each process. Benchmarking timeliness is the third phase of this project.	Target completion date: Jan-2002.
11. <b>Performance 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.	Not Started	It should be noted that during our review of the status of open audit recommendations, code enforcement inspectors provided us with updated information showing significant improvements in the timeliness of enforcement. We will verify this information during our upcoming audit.	Target completion date: Jun-2002
12. <b>Controls Review of the Proposed Enterprise Resource Planning (ERP) System</b> – The City Auditor has been asked to participate in selected ERP	Not Started	We plan to begin this project in May/June-2002.	Target completion date: TBD.

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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>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	We plan to conduct at least one review in Spring 2002.	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>	Not started	We plan to conduct at least one review in Spring 2002.	Target completion date: TBD.