



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

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

**September 19, 2001**

### **Auditor's Office Annual Plan 2001-02**

The Palo Alto Municipal Code requires the City Auditor to submit an Annual Plan to the City Council for review and approval. This report presents the proposed Auditor's Office Annual Plan for the remainder of fiscal year 2001-02.

#### **Background**

The mission of the City Auditor's Office is to promote honest, efficient, effective and fully accountable City government. To fulfill this mission, the Auditor's 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.

On August 6<sup>th</sup>, 2001, Mayor Eakins appointed an ad hoc committee of Vice Mayor Ojakian and Council Members Beecham and Wheeler to work with the new City Auditor to prepare an audit plan for the remainder of the fiscal year. The proposal outlined below incorporates input from the ad hoc committee, City Manager, City Attorney, other City Council Members, and staff.

#### **Discussion of Proposed Assignments**

The proposed list of assignments for the remainder of fiscal year 2001-02 includes administrative items, on-going assignments, and several new assignments. The list includes a mix of audits and special projects that address a wide range of concerns and are consistent with the City Auditor's areas of responsibility. We tried to limit the number of audits to what we realistically can accomplish. Where possible, we have accommodated the City Manager's concerns about the effect of these projects on departmental workloads.

Acknowledging that there is a natural tension between being the independent City Auditor and being a cooperative member of the City team, we have deliberately included several projects that emphasize collaboration between the Auditor's Office and other City staff. These projects are designed to use the independent, analytical skills of the Auditor's Office to support staff initiatives without impairing the Auditor's organizational independence.

A brief description of the preliminary objectives of each assignment follows.

#### **ADMINISTRATIVE ITEMS:**

1. **Auditor's Office General and Administrative** – 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.

2. **Annual Audit Plan and Quarterly Status Reports** – 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 **risk assessment model** (a "key plan" item in the 2001-03 Adopted Budget) to prepare the 2002-03 annual audit plan. We will also develop an **annual report** that identifies the outcomes/accomplishments that result from internal audit efforts (a "key plan" item from the 2001-03 Adopted Budget).
3. **Audit Recommendation Status** – 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.

#### **ON-GOING ASSIGNMENTS:**

4. **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. During 2001-02, this will include:
  - Participating in audit progress meetings and GASB 34 implementation planning sessions;
  - 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
  - Contracting for the June 30, 2002 audit of the City's financial statements.
5. **Quarterly Sales Tax Reviews** – 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.

#### **NEW ASSIGNMENTS:**

6. **Contracted Revenue Audit Services** – 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). Next year, depending on the results of these audits, we will reassess whether it is cost/beneficial to conduct on-going audits, and whether they should be conducted in-house.

- **Property Tax** – Property tax represents about \$12.2 million or 10 percent of projected 2001-02 City revenue. The objective of the audit is to ensure that County assessment data for properties in Palo Alto is current and accurate.
  - **Documentary Transfer Tax** – The documentary transfer tax is a one-time tax that is levied when residential and commercial properties are sold. Projected documentary transfer tax revenue for 2001-02 is \$3.8 million. The objective of the audit is to ensure that transfer taxes are properly applied and remitted timely.
  - **Transient Occupancy Taxes (TOT)** – TOT revenues represent approximately \$10.3 million or 8 percent of total General Fund revenue for 2001-02. The audit task is to review hotel records to ensure that TOT revenues are collected properly and remitted to the City timely.
  - **Utility Users Tax (UUT)** – Projected UUT revenue for 2001-02 is \$6.7 million. UUT is calculated at 5 percent of electricity, gas, water, and telephone service. The audit task is to verify that telecommunications companies are collecting UUT properly and remitting amounts due timely.
7. **Assessment of Utility Risk Management Procedures** – 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 Auditor's Office will monitor major utility initiatives that come forward to the City Council's Standing Oversight Committee, the Utilities Advisory Commission, and other committees as appropriate. This will include staying apprised of actions taken by the City Manager's internal Risk Oversight Committee. 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. **Independent Analysis of the Long-Term Financial Plan** – The City Manager will be presenting an update to the long-term financial plan this fall. The City Auditor has been asked to provide an independent assessment of the feasibility and completeness of the plan.
  9. **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 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. Although the report will offer insights on service results, it is intended to be informational and will not thoroughly analyze individual service results. It will, however, give the Council, staff, and the public an independent, impartial assessment of past performance to help make better decisions about the future.
  10. **Review of the Timeliness of Infrastructure Contract Processing** – 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.
  11. **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.

12. **Controls Review of the Proposed Enterprise Resource Planning (ERP) System** – 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.
13. **Other Bureaucracy Buster Initiatives** – 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:
  - Reviewing the City's write-off policy for NSF (not sufficient funds) checks less than \$25.
14. **Other Reviews of Financial Procedures and Controls** – 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:
  - Verifying that the Golf Pro's procedures for handling golf course receipts conform to City procedures.

## Resource Impact

The above list is an extremely optimistic and aggressive plan for a small audit shop. Estimating the length and scope of any new audit project is difficult because "it all depends on what we find once we get in there." Our quarterly reports to the City Council will provide us with the opportunity to reprioritize projects and amend the audit plan as necessary during the year.

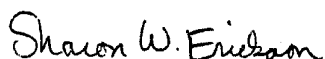
The ability to accomplish the tasks on this plan will depend on being able to successfully fill our vacant auditor position. I also plan to make internship opportunities available to students from local universities. It should be noted that although contracting for revenue audit services on a contingency-fee basis ensures a net gain for the City, a budget adjustment may be necessary to cover audit fees.

## Next Steps

Over the next several months, I will meet periodically with the ad hoc audit committee to ensure that audit progress is communicated to Council. Additional requests for assistance, if any arise during the year, will be referred through the ad hoc audit committee. As described above, I will also provide the City Council with a quarterly report describing the status and progress towards completing these assignments.

I would like to take this opportunity to thank the City Council's ad hoc audit committee, City Manager and his staff, and City Attorney for their advice and assistance in preparing this proposed audit plan. We look forward to a productive year.

Respectfully submitted,



Sharon W. Erickson  
City Auditor