



**OFFICE OF THE  
CITY AUDITOR**

**ACTIVITIES AND ACCOMPLISHMENTS  
OF THE OFFICE OF THE CITY AUDITOR  
JULY 1995 THROUGH JUNE 1997**

**A REPORT TO THE  
SAN JOSE  
CITY COUNCIL**

**DECEMBER, 1997**

**97-07**



# CITY OF SAN JOSÉ, CALIFORNIA

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GERALD A. SILVA  
City Auditor

December 3, 1997

Honorable Mayor and Members  
of the City Council  
801 North First Street, Room 600  
San Jose, CA 95110

This is a report on the *Activities And Accomplishments Of The Office Of The City Auditor For The Period July 1, 1995, Through June 30, 1997.*

The two years covered in this report have been productive, challenging, and rewarding. I am very grateful to the City Council for the support given this Office. I am also grateful to the City Administration for its cooperation during the conduct of our audits. While this Office has improved over the past two years, further improvements are possible and necessary. This Office will continue to strive to secure those improvements for the City Council and, ultimately, the residents of San Jose. I will present this report to the Finance Committee at its December 10, 1997, meeting.

Sincerely,

Gerald A. Silva  
City Auditor

finaltr  
GS:emc





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## **EXECUTIVE SUMMARY**

This report on the Office of the City Auditor summarizes the activities and accomplishments for the period from July 1995 through June 1997.

The goal of the Office is to promote accountability to the public and to improve the economy, efficiency, and effectiveness of City government. Audits have benefited the City in numerous ways. For example, some audit reports have presented ways to reduce costs or increase revenues. In addition, other audit reports have identified opportunities to increase effectiveness, use resources more efficiently, and improve internal controls. Furthermore, a variety of special studies and analyses have provided objective, timely information to the City Council, City Administration, and the general public.

The Office's principal objective is to identify \$3 in savings or increased revenues for every \$1 of audit cost. During the past two years, the Office significantly exceeded this standard by identifying \$9 in savings or increased revenues for every \$ of audit cost. Specifically, from July 1995 through June 1997, the Office produced 24 reports and special studies containing 118 recommendations. These reports identified \$26.4 million in opportunities to reduce costs or increase revenues compared to \$2.9 million in audit costs. Most of the recommendations have been implemented or are in the process of being implemented.

## **INTRODUCTION**

With City of San Jose (City) and Redevelopment Agency operating and capital budgets of over \$1 billion a year, the members of the San Jose City Council need an effective means to monitor the use of tax dollars and City and Redevelopment Agency activities and programs. As an independent audit function, the Office of the City Auditor (Auditor's Office) plays an integral role in the oversight process. Findings and recommendations developed through the audit process have helped save tax dollars, increase revenue, and improve the management of City and Redevelopment Agency programs. Additionally, our independent reviews have served as an important, objective information source for the City Council, City management, the Redevelopment Agency, and the general public.

### **Authority And Responsibility**

The San Jose City Charter prescribes the powers and duties of the Auditor's Office. Section 805 of the Charter grants to the City Council the authority to appoint the City Auditor. The Charter also outlines the City Auditor's primary duties as follows:

- *Conduct or cause to be conducted annual post audits of all the City's fiscal transactions and accounts kept by or for the City including the examination and analysis of fiscal procedures and the examination, checking, and verification of accounts and expenditures;*
- *Conduct performance audits, as assigned by the City Council, to determine whether (1) City resources are being used in an economical, effective, and efficient manner; (2) established objectives are being met; and (3) desired results are being achieved;*
- *Conduct special audits and investigations as assigned by the City Council;*
- *Submit a monthly report to the City Council of the Office activities, findings, and recommendations to improve the administration of the City's fiscal affairs; and*
- *Perform other such auditing functions consistent with the City Charter and submit reports as required.*

Section 805 also grants the City Auditor access and authority to examine all records of any City department, office, or agency, except those of an elected official of the City.

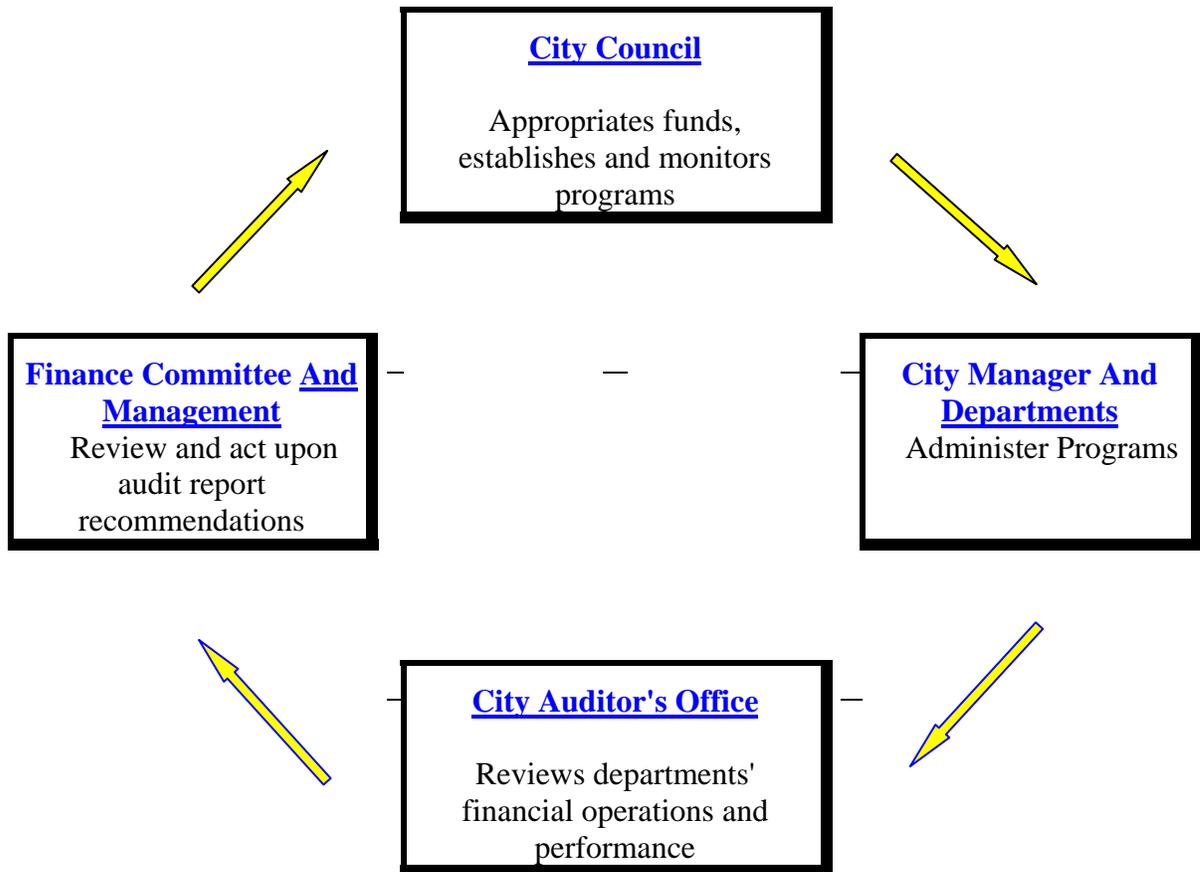
## **Goals, Mission, And Objective**

The goals of the Auditor's Office are to promote accountability to the public and to improve the economy, efficiency, and effectiveness of City government. Our mission is, at the direction of the City Council, to conduct or cause to be conducted financial and program performance reviews of City departments, offices, and agencies in accordance with applicable auditing standards. Our principal objective is to identify \$3 in savings or increased revenue for every \$1 of audit cost.

## **Role Of Auditing In City Government**

The City Auditor's audits and reviews provide insight into City departments, offices, agencies, and their programs. Such audits and reviews are but one step in the process of establishing City programs, evaluating their performance, providing the City Council and City Administration with needed information, and making any necessary changes to ensure that City programs are as efficient and effective as possible. Chart I describes the role of auditing in City government.

**CHART I**  
**ROLE OF AUDITING IN CITY GOVERNMENT**



## **AUDITING CITY DEPARTMENTS AND PROGRAMS**

The Auditor's Office performs or coordinates audits and studies according to government auditing standards promulgated by the United States General Accounting Office (See Appendix A). The following describes the scope of work performed.

### **Financial Audits**

Financial audits include financial statement and financial related audits. Financial statement audits provide reasonable assurance that the financial statements of an audited entity present fairly the financial position, results of operations, and cash flows in conformity with generally accepted accounting principles.

Financial related audits determine whether (a) financial information is presented in accordance with established or stated criteria, (b) the entity has adhered to specific financial compliance requirements, or (c) the entity's internal control structure over financial reporting and/or safeguarding assets is suitably designed and implemented to achieve the control objectives.

In accordance with the City Charter, an independent accounting firm conducts the financial statement and financial related audits of the City of San Jose. The Auditor's Office coordinates the work of the independent accounting firm. The annual audit determines whether the financial statements fairly present the City's financial condition according to generally accepted accounting principles. The annual financial audit also includes reviews to determine City compliance with laws and regulations, particularly for those programs receiving federal funding.

The nature and scope of the financial audits the Auditor's Office performs differ significantly from the outside audit of the City's financial statements. The primary emphasis of the financial audits the Office conducts is to assess whether the City's internal control systems ensure the following:

- *Resources are used in accordance with laws, regulations, and policies;*
- *Reliable data are obtained, maintained, and properly disclosed in financial and management reports; and*
- *Resources are safeguarded against loss due to fraud, theft, errors, and mismanagement.*

These audits provide City management with the objective information required to ensure that internal control systems are working as intended.

### **Performance Audits**

Performance audits include economy and efficiency audits and program audits.

Economy and efficiency audits determine (1) whether the entity is acquiring, protecting, and using its resources (such as personnel, property, and space) economically and efficiently; (2) the causes of inefficiencies or uneconomical practices; and (3) whether the entity has complied with laws and regulations concerning matters of economy and efficiency.

Program audits determine (1) the extent to which City Council-established desired results or benefits are being achieved; (2) the effectiveness of audited organizations, programs, activities, or functions; and (3) whether the audited entity has complied with laws and regulations applicable to the program.

Audits that focus on efficiency issues typically evaluate the reasonableness of program costs relative to the results of services produced. Auditors may assess the relationship between staffing and other costs and measurable program benefits. Auditors may also (1) determine if a program has established appropriate goals and objectives, (2) review the adequacy of management's system for measuring success, (3) assess the extent to which desired levels of results are achieved, and (4) identify factors that inhibit satisfactory performance.

Audit reports usually make recommendations to management to correct inefficient practices and/or improve procedures to maximize resource utilization and productivity. The reports may also make recommendations to change management systems, City policies, and ordinances.

## **Special Studies**

The Auditor's Office is occasionally requested to do thorough and impartial data collection, analysis, and reporting. The Office produces special studies to address these information needs. Special studies and reports are subject to the same rigorous audit methodology regarding data collection and quality control reviews. Special studies are intended to provide timely and objective information to the City Council, City Administration, and the public.

## **Sales And Business Tax Audit**

In July 1994, the Auditor's Office initiated a continuous audit of sales and business taxes. The objectives of this audit are to identify

- San Jose retail businesses that do not file sales tax returns;
- Misallocation of the local portion of the sales taxes paid by San Jose businesses; and
- San Jose businesses that have paid sales taxes but not the San Jose business tax.

## **Audit Recommendations Follow-up**

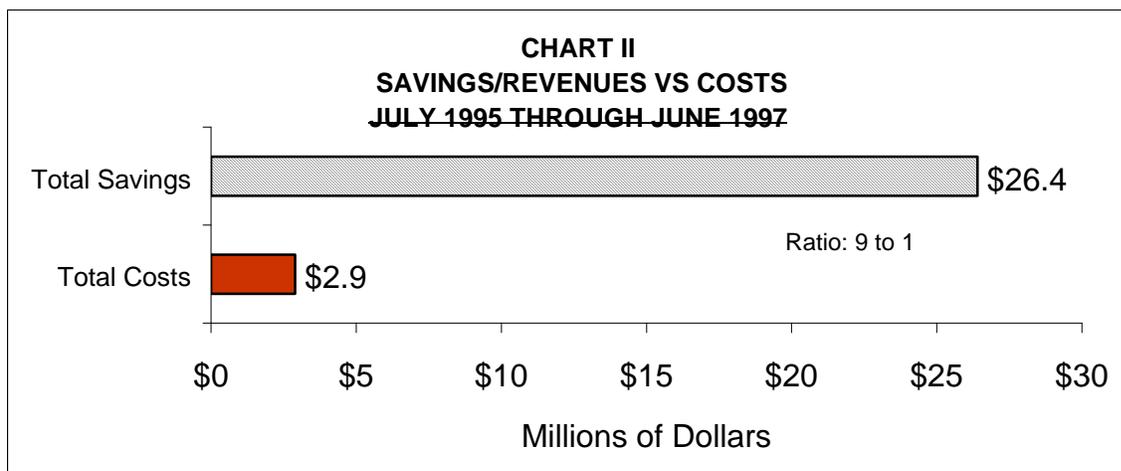
It is the policy of the City that audit reviews be conducted and that any resulting recommendations be implemented or otherwise resolved to the satisfaction of the City Manager, the City Auditor, and the City Council. Accordingly, the Auditor's Office, in coordination with the City Administration, monitors the implementation of audit recommendations. The City Auditor prepares a quarterly follow-up report on the status of all unimplemented City Council-approved audit recommendations.

## **BENEFITS TO THE CITY OF SAN JOSE**

The City Auditor's expanded audit approach has benefited the City of San Jose in a variety of ways. Some audits have resulted in recommendations to reduce costs or increase revenues. Other audits have resulted in recommendations to increase effectiveness, use resources more efficiently, and improve internal controls, or provided objective, timely information to the City Council, City Administration, and the public.

### **Cost Savings And Increased Revenues**

A principal objective of the Auditor's Office is to identify \$3 in savings or increased revenue for every \$1 of audit cost. The Office significantly exceeded this objective from July 1995 through June 1997 by achieving an audit payback ratio of over \$9 in cost savings or increased revenue for every \$1 of audit cost. Specifically, as shown in Chart II, from July 1995 through June 1997, the Auditor's Office identified an estimated \$26.4 million in opportunities for the City to increase revenues or reduce costs. In our opinion, the \$26.4 million is conservative. Specifically, we included only the first year of identified cost savings or additional revenues when, in fact, some of these savings or revenues will be realized year after year. For that same two-year period, audit costs were approximately \$2.9 million.



As Chart III shows, from May 1985 through June 1997, the Auditor's Office identified \$93 million in cost savings or revenue enhancements against \$13 million in audit costs, achieving a 12-year audit payback ratio of \$7 in cost savings or increased revenue for every \$1 of audit cost.

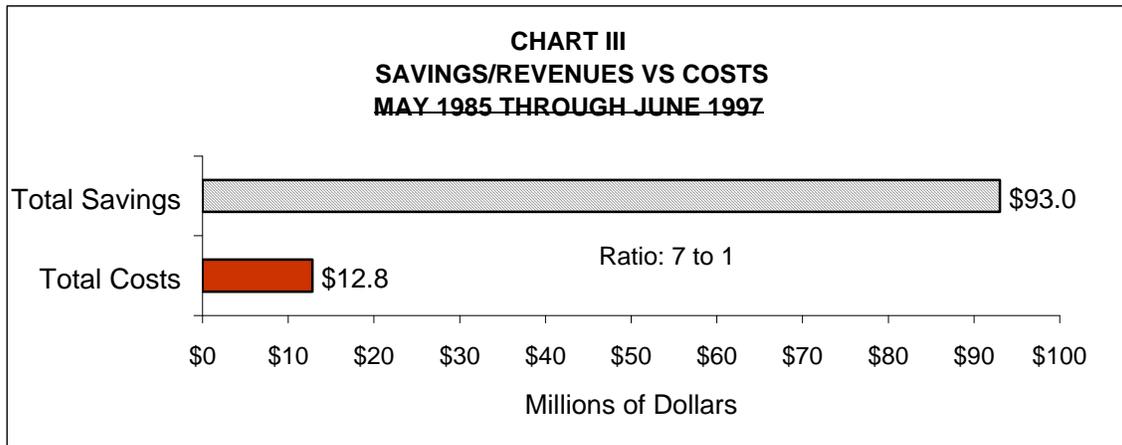
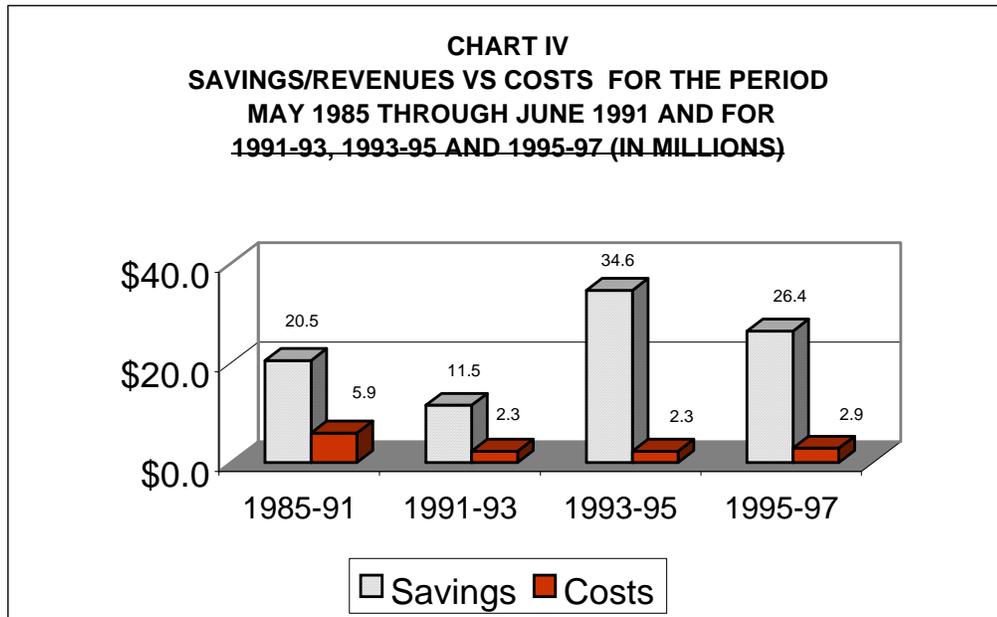


Chart IV compares the cost savings or revenue enhancements against the audit costs for the period May 1985 through June 1991 and for 1991-93, 1993-95, and 1995-97.



## **Other Benefits To The City**

In addition to identifying cost savings and increased revenues, the Auditor's Office has benefited the City in the following ways:

- ***Improved Effectiveness And Efficiency.*** Audit recommendations have addressed ways auditees can improve their operations by increasing effectiveness and efficiency.
- ***Strengthened Internal Controls.*** Audits have also identified ways to improve departmental and program internal controls, safeguard assets, and reduce the risk of potential liability to the City.
- ***Provided Objective Information.*** Audit reports and special studies have also provided reliable, objective, and timely information to decision-makers and the public. This information has assisted the City Council and City Administration in making needed policy and administrative changes and has informed the public about the management of City government.

## **OFFICE OPERATIONS**

Section 805 of the City Charter establishes the Auditor's Office and provides for the City Council to appoint the City Auditor and the manner in which the City Council may remove the City Auditor from office. Specifically, Section 805 states in part:

*The office of City Auditor is hereby established. The City Auditor shall be appointed by the Council. Each such appointment shall be made as soon as such can reasonably be done after the expiration of the latest incumbent's term of office. Each such appointment shall be for a term ending four (4) years from and after the date of expiration of the immediately preceding term; provided, that if a vacancy should occur in such office before the expiration of the former incumbent's terms, the Council shall appoint a successor to serve only for the remainder of said former incumbent's term.*

*The office of City Auditor shall become vacant upon the happening before the expiration of his term of any of the events set forth in subsections (a), (b), (c), (d), (e), (h), (i), (j), (k) and (l) of Section 409 of this Charter. The Council, by resolution adopted by not less than ten (10) of its members may remove an incumbent from the office of City Auditor, before the expiration of his or her term, for misconduct, inefficiency, incompetence, inability or failure to perform the duties of such office or negligence in the performance of such duties, provided it first states in writing the reasons for such removal and gives the incumbent an opportunity to be heard before the Council in his or her own defense; otherwise, the Council may not remove an incumbent from such office before the expiration of his or her term.*

The City Council's Finance and Rules Committees directly oversee the work of the City Auditor. The Finance Committee reviews and approves the City Auditor's annual audit workplan, subsequently reviews and approves audit report findings and recommendations, submits audit reports and approved recommendations to the full City Council for concurrence, and monitors the implementation of approved recommendations. The Rules Committee is responsible for approving City Councilmember or City Administration requests for audit services as they arise during the year.

### **Budget**

Since 1985-86, the budget of the Auditor's Office has averaged about \$1.2 million per year, with approximately 94 percent spent for salaries and benefits (See Table I). City Auditor

staffing has averaged 17 authorized full-time positions, including both audit and administrative staffs. In addition, the Office provides employment and training to eight part-time student interns. Due to a Citywide hiring freeze, the Office has operated at a reduced staffing level since 1988-89. As of 1997-98, the Office has not yet fully regained its 1987-88 staffing level of 19 authorized positions.

**TABLE I**  
**OFFICE OF THE CITY AUDITOR**  
**ADOPTED BUDGET AND STAFFING LEVEL**  
**FROM 1985-86 TO 1997-98**

<u>Fiscal Year</u>	<u>Authorized Positions</u>	<u>Personal</u>	<u>Nonpersonal</u>	<u>Equipment</u>	<u>Total Budget</u>
1985-86	19	\$ 944,919	\$92,410	\$21,647	\$1,058,976
1986-87	19	948,853	94,700	32,266	1,075,819
1987-88	19	974,660	56,475	0	1,031,135
1988-89	18	979,231	49,475	0	1,028,706
1989-90	18	1,106,756	40,025	9,100	1,155,881
1990-91	18	1,122,442	50,265	17,500	1,190,207
1991-92	17	1,158,311	50,265	40,000	1,248,576
1992-93	16	1,207,635	50,265	0	1,257,900
1993-94	15	1,097,977	31,064	0	1,129,041
1994-95	15.5	1,175,813	31,064	0	1,206,877
1995-96	16.5	1,344,464	38,836	0	1,383,300
1996-97	17	1,443,006	71,836	0	1,514,842
1997-98	17	1,508,765	160,836	0	1,669,601

**Audit Strategy**

When the City Auditor assumed office in May 1985, he took immediate action to improve the efficiency and effectiveness of the Office's limited resources. He proposed to conduct the City Charter-required fiscal audits more efficiently and to secure additional staff to conduct expanded-scope performance audits.

Initially, the City Auditor reduced the staff time devoted almost exclusively to Charter-required reviews of payroll expenses, nonpersonal services expenses, petty cash and revenue accounts, and parking revenues.

In 1987, the Auditor's Office changed its auditing strategy to reflect new American Institute of Certified Public Accountants (AICPA) pronouncements. In pursuing this audit strategy, the Office implemented a rigorous risk assessment approach to identify any threats (unwanted events) facing the program or activity under audit and to assess those controls or procedures in place to prevent, eliminate, or minimize the threats identified. The Office's risk assessment approach to auditing is widely recognized as an industry standard, and many governmental auditing units have borrowed from and replicated the Office's auditing procedures.

### **Annual Citywide Risk Assessment**

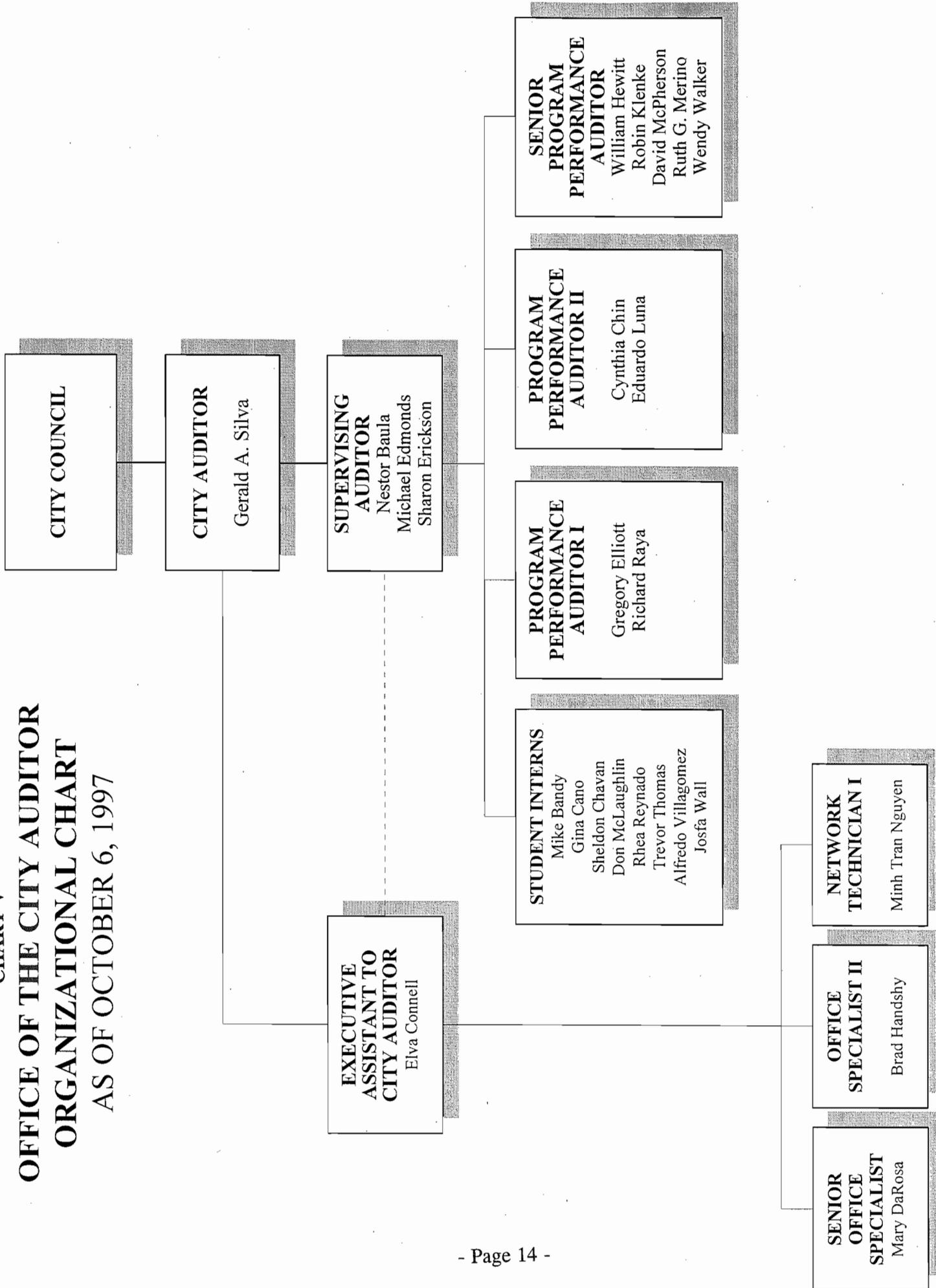
Determining which areas to audit and allocating scarce audit resources to those areas is key to a successful internal audit function. To assess the relative importance of potential audit subjects, the City Auditor's Office prepared an annual risk assessment model of the City's budgeted programs and revenue sources. For each of 296 specific budgeted programs or revenue sources, the Office compares the following factors: proposed expenditures, three-year expenditure trend, fund type, capital expenditures, estimated revenues, three-year revenue trend, number of staff, estimated beginning fund balance, fixed assets, audit requests, and date of last audit.

For each specific budgeted program or revenue source the City Auditor scores each of the above factors from 0 through 10 based on a series of tables the City Auditor designed. In addition, the City Auditor weights each of the above factors from 1 to 5 according to their relative importance to produce a weighted score for each budgeted program or revenue source. The City Auditor then sorts these weighted scores from highest to lowest and recommends that the City Council Finance Committee include in the City Auditor's Annual Audit Workplan those budgeted programs or revenue sources with the highest weighted scores. Because the City Auditor applies this scoring system evenly across the entire citywide organization it promotes a sense of fairness to auditees and helps ensure that City Auditor resources will be focused on those areas with the highest audit potential.

## **Office Staffing**

In 1985, to implement expanded-scope performance audits, the City Council authorized the City Auditor six additional staff for a total of 19 positions. From 1988-89 through 1997-98, the City Auditor's Office has operated at a reduced staffing level due to budget constraints. Currently, the Auditor's Office operates with 17 authorized positions consisting of the City Auditor, three supervising auditors, nine auditors, four administrative staff, and eight part-time student interns. Chart V shows the organizational chart for the Auditor's Office as of October 6, 1997.

**CHART V**  
**OFFICE OF THE CITY AUDITOR**  
**ORGANIZATIONAL CHART**  
**AS OF OCTOBER 6, 1997**



## **Staff Background And Experience**

The members of the Auditor's Office have diverse educational backgrounds and work experience (See Table II). Staff educational backgrounds include accounting, economics, political science, business administration, education, finance, public administration, and linguistics. Further, several staff members have advanced academic degrees and/or professional certifications such as Certified Public Accountant, Certified Government Financial Manager, Certified Internal Auditor, Certified Fraud Examiner, Certified Information Systems Auditor, Certified Revenue Officer, and Certified Quality Auditor. Staff members have had previous experience in public accounting, banking, data processing, education, health care, as well as federal, state, and local government. This wide range of training and experience brings a broad perspective to the variety of audit work the Office conducts.

Members of the staff have been officers or members in the following professional organizations: Institute of Internal Auditors, National Association of Local Government Auditors, National Intergovernmental Audit Forum, Western Intergovernmental Audit Forum, Association of Government Accountants, American Institute of Certified Public Accountants, California Society of Certified Public Accountants, California Municipal Business Tax Association, American Society for Public Administration, Association of Fraud Examiners, Information Systems Audit and Control Association, Women in Government Service, and San Jose Management Association.

The City Auditor is the chairman of the Association of Government Accountants', State and Local Government Committee, a former member of the Board of Governors of the San Jose Chapter of the Institute of Internal Auditors, past president of the National Association of Local Government Auditors, former chairman of the Western Intergovernmental Audit Forum, former local government representative to the prestigious National Intergovernmental Audit Forum Executive Committee, and a former member of the American Institute of Certified Public Accountants' Members in Government Committee.

TABLE II

OFFICE OF THE CITY AUDITOR  
STAFF EDUCATION AND BACKGROUND

AUDITOR	TITLE	EDUCATION	PROFESSIONAL AFFILIATIONS	PRIOR WORK EXPERIENCE
Gerald A. Silva, CPA, CGFM	City Auditor	Bachelor of Science, Accounting, 1967	Former member of the Board of Governors, IIA, San Jose Chapter; Past President, National Association of Local Government Auditors; Former Chairman, Western Intergovernmental Audit Forum; Former Local Government Representative, National Intergovernmental Audit Forum Executive Committee Member; Former AICPA Members In Government Committee; GFOA; Who's Who in Government; California & Arizona State Boards of Accountancy; Chairman of the Association of Government Accountants', State and Local Government Committee for 1997-98	State Budget Director, State of Arizona  Director of Program Auditing, State of Arizona  Audit Manager, California Auditor General's Office  Public Accounting
Nestor S. Baula, CPA, CIA	Supervising Auditor	Bachelor of Science, Accounting, 1971	Member, IIA; Association of Certified Fraud Examiners; California Society of CPAs	Senior Auditor, Castle & Cooke, Inc.
Michael Edmonds, CIA	Supervising Auditor	Bachelor of Arts, Political Science, 1974	Member, IIA; Member, National Association of Local Government Auditors	Internal Auditor, Contra Costa Water District, Staff Auditor, California Office of the Auditor General
Sharon W. Erickson, CIA, CGFM	Supervising Auditor	Bachelor of Arts, Political Science	Member, IIA, San Jose Chapter; Member, National Association of Local Government Auditors	Controller, Smith, Erickson, McDonald, Inc.
William P. Hewitt, CIA, CISA, CFE, CQA, CGFM, CMA	Senior Program Performance Auditor	Bachelor of Arts, Political Science, 1975	Member, IIA; Member, Association of Certified Fraud Examiners, Institute of Management Accountants	Internal Audit Manager, Kelly-Moore Paint Co.

**OFFICE OF THE CITY AUDITOR  
STAFF EDUCATION AND BACKGROUND**

AUDITOR	TITLE	EDUCATION	PROFESSIONAL AFFILIATIONS	PRIOR WORK EXPERIENCE
Ruth Garcia Merino, CISA, CGFM	Senior Program Performance Auditor	Bachelor of Science, Business Admin, Finance and Accounting, 1978	Member, IIA, San Jose Chapter; Member, Information Systems Audit and Control Association.	Business Banking Officer, Bank of America
Robin A. Klenke, MBA, CGFM	Senior Program Performance Auditor	Bachelor of Arts, Anthropology/Linguistics, 1982 M.B.A., 1986	President, IIA, San Jose Chapter; Membership Chair, ASPA, Santa Clara Valley Chapter; Member, National Association of Local Government Auditors.	Manager/Chief Technician, El Camino Hospital
Wendy Walker, CGFM	Senior Program Performance Auditor	Bachelor of Science, Accounting, 1986.	President, WINGS; Boardmember, SJMA.	Supervising Senior Accountant, KPMG Peat Marwick
David McPherson, MPA, CRO <i>(Hired after June 30, 1997)</i>	Senior Program Performance Auditor	Bachelor of Arts, History, 1986 M.P.A., 1993	President, CMBTA Div III; Member, CMBTA State Board	Revenue Technician, City of Newport Beach
Eduardo Luna, MPA, CGFM	Program Performance Auditor II	Bachelor of Science, Political Science, 1987 M.P.A., 1989	Member, IIA, San Jose Chapter Member, National Association of Local Government Auditors	Evaluator, U.S. General Accounting Office; Urban Consortium Manager, Public Technology, Inc.
Cynthia Chin, CPA	Program Performance Auditor II	Bachelor of Science, Accounting, 1991	Member, IIA, San Jose Chapter	Supervising Senior Accountant, KPMG Peat Marwick
Gregory W. Elliott, M.A.	Program Performance Auditor I	Associate in Arts, 1987 Bachelor of Science, 1989 M.A., Economics, 1992	Member, IIA, San Jose Chapter	Auditor Intern, City Auditor's Office, San Jose, CA.
Richard W. Raya, MPP	Program Performance Auditor I	Bachelor of Arts English, 1993 M.P.P., 1996	Member, IIA, San Jose Chapter	Consultant, Mayor's Office of Children, Youth and their Families, San Francisco, CA

**OFFICE OF THE CITY AUDITOR  
STAFF EDUCATION AND BACKGROUND**

AUDITOR	TITLE	EDUCATION	PROFESSIONAL AFFILIATIONS	PRIOR WORK EXPERIENCE
Elva Connell	Executive Assistant to the City Auditor	Associate in Arts, Social Sciences, 1983	Notary Public	Office Manager, Nolte and Associates, Inc.
Minh Tran Nguyen	Network Technician	Associate in Arts, Office Administration & Word Processing, 1985 Certificate; Network 4 Admin, 1996 Admin MS Windows NT, 1997		Secretary, IBM Corporation
Mary Da Rosa	Senior Office Specialist	Word Processing, 1986 Clerical Support, 1989.		Title Examiner, American Title Insurance Company
Brad Handshy	Office Specialist II	Administrative Assistant Certificate, 1991		Desktop Publishing Assistant, VLSI Research; English Writing Sample Evaluator, East Side Union High School District.
Mike Bandy	Intern - Revenue Audit Unit	Associate of Arts, Liberal Arts, 1995 Currently attending San Jose State University.		None.
Don McLaughlin	Intern - Revenue Audit Unit	Currently attending San Jose State University, major in Accounting		Recreation Leader, San Jose Parks & Recreation
Alfredo Villagomez	Intern - Revenue Audit Unit	Associate of Arts, Business Admin, 1996 Currently attending San Jose State University, major in Bus Adm/Accounting & MIS		Food Server, Hayes Conference Center

**OFFICE OF THE CITY AUDITOR  
STAFF EDUCATION AND BACKGROUND**

Gina Cano	Intern - Revenue Audit Unit	Associate of Science, Business Admin, 1995 Currently attending San Jose State University, major in Bus Adm/Accounting.	Asst Manager/Bookkeeping, CD Warehouse Accounting Clerk Yegge-Schultz Packaging
Sheldon Chavan	Intern - Revenue Audit Unit	Currently attending San Jose State University, major in Accounting	Deli Manager, Food-4-Less,
Rhea Reynado	Intern - Revenue Audit Unit	Currently attending San Jose State University, major in Bus Adm/Accounting	Office Assistant, State Farm Insurance Student Assistant, Sonoma State University
Trevor Thomas	Intern - Revenue Audit Unit	Bachelor of Science Marketing, 1991 Currently attending San Jose State University, major in Accounting	Payroll Admin, Octel Communications Accessories Manager, CompUSA
Josfa Wall	Intern - Revenue Audit Unit	Currently attending San Jose State University, major in Bus Adm/Accounting	Advertising Paper Potpourri

**Abbreviations**

AICPA	American Institute of Certified Public Accountants	CRO	Certified Revenue Officer
ASPA	American Society for Public Administration	GFOA	Government Finance Officers Association
CFE	Certified Fraud Examiner	IIA	Institute of Internal Auditors
CGFM	Certified Government Financial Manager	M.A.	Master of Arts
CIA	Certified Internal Auditor	M.B.A.	Master in Business Administration
CISA	Certified Information Systems Auditor	M.P.A.	Master in Public Administration
CMA	Certified Management Accountant	M.P.P.	Master in Public Policy
CMBTA	California Municipal Business Tax Association	SJMA	San Jose Management Association
CPA	Certified Public Accountant	WINGS	Women in Government Service
CQA	Certified Quality Auditor		

## **Office Of The City Auditor Performance Audit**

The City Charter requires the Auditor's Office to undergo a peer review performance audit on a biennial basis. Specifically, Section 805.2 of the City Charter states:

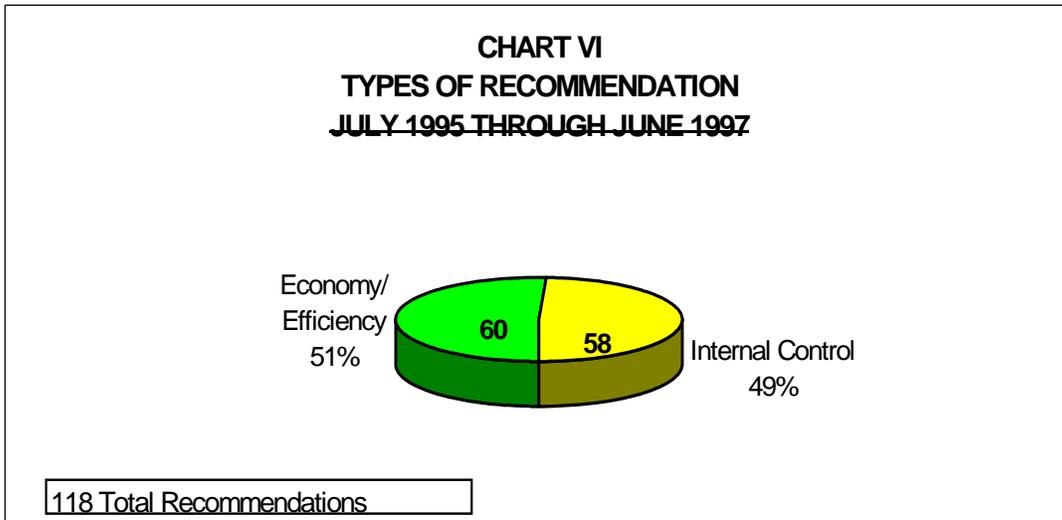
*The Council shall contract with an independent audit firm, which has no other contracts with the City, to conduct a performance audit of the City Auditor's office at least every two years. The report of the performance audit shall be available to the public.*

The Office has undergone five audits since the performance audit requirement was instituted. In June 1987, the Office underwent its first such performance audit. A management representative from the California Auditor General's Office performed the review according to National State Auditors Association (NSAA) standards. This initial audit focused on the Office's formal written audit and office administration procedures and controls. The purpose of the audit was to determine if the procedures and controls provided reasonable assurance that City Auditor audits would meet the specified standards. Following the audit, the Auditor General issued two letters. One letter expressed an overall unqualified (clean) opinion on the City Auditor's system of quality control. The other letter identified opportunities to improve the Office's system of quality control, all of which have been implemented.

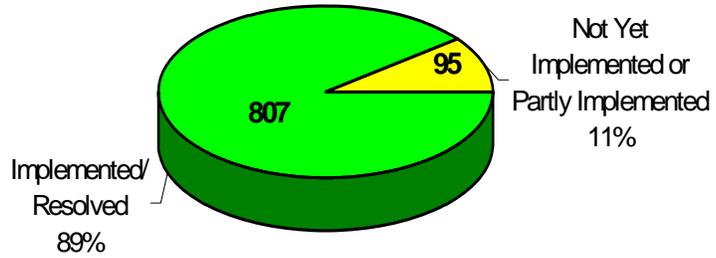
Independent auditors conducted the Office's subsequent performance audits in 1989, 1991, 1993, 1995 and 1997. The objective of these audits was to determine the Office's compliance with generally accepted government auditing standards, based on the peer review guidelines issued separately by the National State Auditor's Association (NSAA) and the National Association of Local Government Auditors (NALGA). The independent auditors' 1989, 1991, 1993, 1995 and 1997 reports stated that the Office of the City Auditor was in compliance with Government Auditing Standards. Appendix C shows the independent auditor's 1997 report.

**SUMMARY OF WORK PERFORMED**  
**JULY 1995 THROUGH JUNE 1997**

From July 1995 through June 1997, the Auditor’s Office completed 24 performance/financial audit reports and special studies and 8 recommendation follow-up reports. These audit reports contained 118 recommendations to improve the economy, efficiency, effectiveness, and strengthen internal controls within City government. Since the City Auditor started in May 1985, the Office has made 902 such recommendations. To date, the City Administration and the Redevelopment Agency have fully implemented or resolved over 89 percent of these recommendations. Charts VI and VII show the status of implementation and the types of recommendations made from May 1985 through June 1997. Chart VIII shows the number of recommendations made, including internal control and efficiency/effectiveness recommendations, from July 1995 through June 1997. Schedule I (page 22) summarizes the activity costs and results for the period of July 1995 through June 1997.

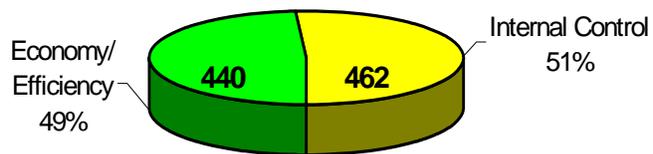


**CHART VII  
STATUS OF RECOMMENDATIONS  
AS OF JUNE 30, 1997**



902 Total Recommendations

**CHART VIII  
TYPES OF RECOMMENDATIONS--  
MAY 1985 THROUGH JUNE 1997**



902 Total Recommendations

**SCHEDULE 1**

**SUMMARY OF ACTIVITY COSTS AND RESULTS  
FOR THE PERIOD JULY 1995 THROUGH JUNE 1997**

<b>Report Number</b>	<b>Date</b>	<b>Audit Report Title</b>	<b>Audit Costs</b>	<b>Identified Opportunities to Increase Revenues or Reduce Costs</b>	<b>Number of Recommendations to Improve Efficiency/ Effectiveness</b>	<b>Number of Recommendations to Strengthen Internal Controls</b>
95-04	Aug 95	An Audit of the City of San Jose Retirement Plans' Investment Program	\$13,858 <sup>A</sup>	\$9,472,000	6	8
95-06	Oct 95	An Audit of the San Jose Arena Management Agreement	\$29,539		7	9
9525	Dec 95	Financing Options for the Redevelopment Agency's 1995-96 Through 1999-2000 Capital Improvement Program	\$32,031	\$2,000,000	1	0
96-01	Jan 96	An Audit of the General Services/Fleet Management Division – Performance Standards	\$29,417		3	0
96-02	Mar 96	A Financial Evaluation of the Emergency Housing Consortium	\$11,852		0	0
96-03	May 96	An Audit of the City of San Jose's Traffic Citation Collection Process	\$83,937	\$610,000 <sup>B</sup>	4	0
96-04	Jun 96	Santa Clara County Cities Association Audited Financial Statements for the Years Ended June 30, 1994 and 1995	\$5,956		1	1
96-05	Sep 96	An Evaluation of the Feasibility of the City of San Jose Selling the San Jose Municipal Water System	\$174,499	<sup>C</sup>	0	0
96-06	Dec 96	An Audit of the City of San Jose's Business Tax Collection Process	\$11,244	\$629,000	4	0
96-07	Dec 96	An Audit of the City of San Jose's Open Purchase Order Process	\$244,214	\$200,000	15	13
97-01	Apr 97	An Audit of the City of San Jose's Utility Billing System	\$141,069	\$3,900,000	13	9
97-02	Apr 97	An Audit of the City of San Jose's Housing Rehabilitation Program	\$198,203		5	18

**SCHEDULE 1 - continued**

Report Number	Date	Audit Report Title	Audit Costs	Identified Opportunities to Increase Revenues or Reduce Costs	Number of Recommendations to Improve Efficiency/ Effectiveness	Number of Recommendations to Strengthen Internal Controls
97-03	Jun 97	A Review of the City of San Jose's Commercial Solid Waste Franchise and AB 939 Fees	\$81,911	\$3,300,000	1	0
<b>OTHER ASSIGNMENTS AND ADMINISTRATION HOURS</b>						
9704	Mar 97	Oversee Independent Audits of Sutter's Inc., d.b.a. Bay 101	\$6,564			
9522	Mar 96	RFP & Selection of City's Independent Auditors	\$6,443	\$77,000		
9705	Apr 97	Property Tax Allocation Process – Interim Reports	\$66,615	\$2,682,000		
Quarterly		Sales and Business Tax Audit	\$157,542	\$3,499,000		
Quarterly		Recommendations Follow-up	\$51,420			
		Internal Audit Quality Control	\$274,421			
		Departmental Administration	\$359,392			
		Vacation, Holiday, and Other Leaves	\$189,694			
		Training	\$78,588			
		Miscellaneous Projects and Activities	\$139,064			
		Dropped or Deferred Assignments	\$5,470			
		Prior Period Assignments	\$19,753			
		Assignments in Progress	\$506,320			
		<b>TOTALS</b>	<b>\$2,919,016</b>	<b>\$26,369,000</b>	<b>60</b>	<b>58</b>

<sup>A</sup> Total audit cost was \$64,726 including the prior year.

<sup>B</sup> Recent legislation effective in July 1998 has increased the estimated Traffic Citations additional revenues to approximately \$2.4 million.

<sup>C</sup> The report addressed the alternative mechanisms to determine that value of the San Jose Municipal Water System (SJMWS) and the net proceeds which the City might receive from a sale. If the City sold the SJMWS, the proceeds could be as much as \$40 million. The \$40 million in potential proceeds could be reduced by as much as \$10 million in bond refundings and \$3 million in sales and transaction costs. The report also identified the following alternative financial benefit options: (1) annual revenues over the next 13 years from \$1.7 million to \$2.8 million by establishing a reasonable rate of return in a water rate policy; (2) a one-time transfer of approximately \$7 million in SJMWS cash reserves derived from water service charges; or (3) potential bond proceeds to the General Fund for capital projects in 1996-97 of about \$22 million.

## **SUMMARY OF AUDIT REPORTS AND SPECIAL STUDIES**

The following summarizes the audit reports and special studies that the Auditor's Office has issued from July 1995 through June 1997.

### **An Audit Of The City of San Jose Retirement Plans' Investment Program (August 1995)**

*Opportunities Exist To Increase Retirement Fund Earnings And Reduce Investment Costs By (1) Enforcing Performance Objectives On Investment Managers, (2) Increasing Use Of Performance-Based Fees, (3) Reducing The Number Of Investment Managers, And (4) Increasing Use Of Index Funds*

The Federated City Employees' Retirement System's (Federated Plan) and the Police and Fire Department Retirement Plan's (Police and Fire Plan) investment portfolios are composed of fixed income securities (bonds), equities (stocks), and real estate. The two plans use 24 external investment management firms to manage the \$1.4 billion portfolio. Over the past ten years, the plans' bond managers generally outperformed the market indexes. However, over that same period, the two plans have engaged 21 different outside equity managers who have cumulatively performed below equity industry benchmarks. Our review revealed that

- The majority of investment managers have underperformed the performance objectives outlined in the retirement funds' investment policies;
- The retirement plans do not have a formal probationary process for investment managers;
- Investment manager contracts do not specify management style, performance standards, or probationary processes;
- Eight of the investment management firms were founded less than ten years ago;
- Only one manager is paid a performance-based fee; and
- The large number of investment managers increases costs and imposes a burden on Retirement Program staff.

Finally, most public pension plans have a larger portion of their equity portfolios invested in equity indexes. For example, the California Public Employees' Retirement System has 80 percent of its equity portfolio invested in an equity index. In contrast, the City's retirement plans have only 5 to 6 percent of their domestic equity portfolios invested with index managers. If the retirement plans' equity portfolios had been invested in an equity index fund instead of with the variety of managers that were used, we estimate that the portfolios could have earned an additional \$72.8 million over the last ten years and saved about \$10 million in management fees paid to equity managers. These additional earnings and fee savings would have improved upon the funded status of both retirement plans as of June 30, 1993. Further, we estimate the retirement funds may be able to earn up to \$7.1 million a year more if they index their equity portfolios. In addition, investment management fees could be reduced by up to \$1.9 million annually. Accordingly, the boards of administration for the retirement plans should increase the use of equity index funds. In addition, the boards should establish formal probationary processes for investment managers whose performance falls below applicable standards, increase use of performance-based fees, and reduce the number of investment managers.

*Opportunities Exist To Enhance The Retirement Boards' Ability To Assess The Status Of The Investment Portfolios*

The San Jose Municipal Code requires monthly reporting of short- and long-term retirement fund investments. However, our review revealed that the funds' monthly investment reports are not issued in a timely manner and that millions of dollars in short-term retirement fund investments are not included in the monthly investment transaction resolutions. Moreover, in spite of the fact that asset allocation decisions determine investment performance and have potential multi-million-dollar effects on investment earnings, the Federated Plan's and the Police and Fire Plan's asset allocations and investment policies were not comprehensively reviewed for several years. In our opinion, the respective boards of administration should improve the timeliness and completeness of reporting on the status of the investment portfolios and establish procedures to annually review investment policies and asset allocation strategies.

*Charging The Retirement Plans For Services  
The Finance Department Provides Would Reduce  
General Fund Expenditures By \$61,000 Per Year  
And Pooled Investment Fund Expenses By \$11,000 Per Year*

The Finance Department provides certain unreimbursed accounting services to the retirement funds. The General Fund and the Pooled Investment Funds absorb the cost of these activities. By charging the retirement plans for these costs, the General Fund would save about \$61,000 per year and the Pooled Investment Funds would save about \$11,000 per year.

**An Audit Of the San Jose Arena Management Agreement (October 1995)**

*The City Of San Jose And The San Jose Arena Management Corporation  
Need To Perform Various Tasks To Ensure Compliance  
With The Management Agreement*

The San Jose Arena Management Agreement (Agreement) addresses the operation and management of the San Jose Arena facilities. Our audit focused on those areas of the Agreement that contain compliance requirements. Our review revealed 90 instances of compliance with the terms of the Agreement and 29 instances of noncompliance with the terms of the Agreement. In addition, we identified 28 terms for which compliance needs to occur at a future date. The following table summarizes the terms for which we found compliance and noncompliance with specific sections of the Agreement.

**SUMMARY OF COMPLIANCE OR  
NONCOMPLIANCE WITH THE TERMS  
OF THE AGREEMENT SUBJECT TO AUDIT**

<b>Agreement Section</b>	<b>Section Name</b>	<b>Number Of Terms In Compliance</b>	<b>Number Of Terms Not In Compliance</b>	<b>Number Of Future Compliance Terms</b>	<b>Other</b>
2.01	Term	0	1	0	0
3.03	NBA Or Other Professional Sports Team	0	1	0	1
4.01	In General	7	0	0	0
4.02	Operating Performance Standards	2	0	0	0
4.03	Limitation On Term Of Leases, Licenses, Contracts And Commitments	3	0	0	0
4.08	Maintenance Standard	1	1	0	0
4.09	Security And Security Personnel	1	0	0	1
4.11	Consultation Regarding Prices	1	0	0	1
4.12	Compliance With Laws By Manager	1	1	0	0
4.13	Compliance With Contemporary Community Standards	1	0	0	0
4.16	City Events	1	0	0	0
6.01	Arena Fees	1	0	5	1
6.02	Luxury Suite Net Revenue	0	0	6	0
6.04	Allocated Hockey Gross Ticket Revenue	0	0	2	0
7.02	Capital Repairs, Replacements And Improvements	4	8	5	2
8.01	In General (Bank Accounts)	1	0	1	0
8.02	Ticket Account	0	1	0	0
8.03	Bank Account, Records, And Reports	0	0	1	1
9.02	Annual Budgets	0	3	0	1
10.01	Accounting Records And Reports	0	3	4	1
10.02	Annual Financial Statements	0	2	2	1
10.03	Inspection And Audit Rights	0	0	1	1
10.04	Access To Records	0	0	1	2
11.01	General Requirements (With Regards To Insurance)	0	5	0	0
11.02	Property Insurance	5	2	0	3
15.01	On-Site Parking	3	0	0	1
15.02	Off-Site Parking	7	0	0	1
15.04	Responsibilities Of City And Manager	1	0	0	0
18.01	Space For City And Arena Authority Personnel	0	0	0	2
19.01	Luxury Suites	1	0	0	0
19.02	Complimentary Passes And Tickets To City	2	0	0	0
19.03	Parking Passes	1	0	0	0
Attachment #5	Insurance Requirements	23	1	0	0
Attachment #8	Arena Advertising	18	0	0	1
Attachment #11	Advertising Policies	5	0	0	1
Total		90	29	28	22

By performing various additional tasks, the City of San Jose and the San Jose Arena Management Corporation can correct current instances of noncompliance with the above terms of the Agreement and help ensure future compliance with those terms.

**Financing Options For The Redevelopment Agency's 1995-96 Through 1999-2000 Capital Improvement Program (December 1995)**

The Office of the City Auditor in cooperation with the Redevelopment Agency (Agency), the Mayor's Budget Office, and the Finance Department has reviewed the financing options for the Redevelopment Agency's 1995-96 through 1999-2000 Capital Improvement Program. Our review revealed the following:

- Revised estimates increased Agency tax increments by \$10 million during the 1995-96 through 1999-2000 period;
- As a result of increased estimated Agency tax increments, the Agency may be able to increase its tax allocation bonding capacity by as much as \$66 million during the 1995-96 through 1999-2000 period; and
- As of 1999-2000, the Agency's ending capital reserves could be increased by as much as \$36 million.

In our opinion, the Agency should finance its 1995-96 through 1999-2000 Capital Improvement Program by issuing a \$26 to \$30 million variable rate demand bond during 1995-96 and to the extent possible using tax allocation bonds in 1996-97 through 1999-2000.

**An Audit Of The General Services/Fleet Management Division Performance Standards (January 1996)**

*By Developing And Implementing Performance Standards,  
The Fleet Management Division Can Assess  
Its Operational Effectiveness And Efficiency  
And Its Competitiveness With Private Industry  
And Other Governmental Organizations*

The Fleet Management Division (Fleet Management) of the Department of General Services (General Services) services and maintains automobiles, light trucks, and heavy trucks for General Services and other city of San Jose (City) departments. Fleet Management charges the departments for which it provides services based upon an hourly rate and the number of hours required to perform the services. As such, it is in the best interest of the departments

that Fleet Management provides efficient and effective services that are competitive with private industry and other governmental organizations. Our review of Fleet Management's use of performance standards to assess its competitiveness with private industry and other governmental organizations revealed that

- Performance standards cannot be incorporated into Fleet Management's Equipment Management Information System. As a result, Fleet Management has no procedures to either incorporate performance standards into the EMIS or monitor actual performance against established performance standards;
- The performance standards Fleet Management has developed are not used to assess its competitiveness with private industry or other governmental organizations; and
- Fleet Management has not fully implemented its new fleet management system.

In addition, with regard to privatizing the vehicle maintenance function,

- Our review of authoritative sources and surveys of other governmental jurisdictions revealed that vehicle maintenance services can be successfully privatized and
- Obstacles to privatization, such as union resistance, contracting-out pitfalls, and the City Council's current policy on privatization can be overcome.

In our opinion, Fleet Management should expedite the implementation of its new Equipment Management Information System. By establishing performance standards, developing economic benefit criteria for recommending privatization, and monitoring actual performance against those standards and criteria, Fleet Management will be able to assess if it is functioning economically, efficiently, and effectively and to identify any functions that can be successfully privatized.

### **A Financial Evaluation Of The Emergency Housing Consortium (March 1996)**

#### *The Emergency Housing Consortium Has Improved Its Financial Viability Through Better Financial Management And Debt Restructuring*

For the year ended June 30, 1995, the Emergency Housing Consortium (EHC) experienced an operating deficit of \$171,602 and ended the year with a fund deficit of \$379,032. A major part of the deficit was the result of unanticipated events, including the write-off of development costs of a failed shelter project. Because of the deficit, the EHC was

faced with a serious cash flow problem, necessitating some staff reduction. We reviewed the EHC's unaudited financial statements as of December 31, 1995, and its cash flow projection for the seven months ending June 30, 1996, and performed several other audit procedures. Our examination indicated that the EHC Executive Director and the EHC Board of Directors have taken steps to track revenues and expenditures, generally resulting in improved cash planning and control. Further, we determined that the EHC has restructured or is in the process of restructuring most of its debt. Additionally, we reviewed the status of the EHC's Reception Center. Based upon our review, we did not identify any information that significantly contradicts the going concern assumption of the EHC, as defined in the American Institute of Certified Public Accountants' Statement on Auditing Standards Numbers 59 and 64.

### **An Audit Of The City Of San Jose's Traffic Citation Collection Process (May 1996)**

*Available And Practical Collection Alternatives  
For Traffic Citations Could Generate One-Time Revenues  
Of \$450,000 For The City Of San Jose,  
And Increase Annual Revenues About \$160,000.  
Similarly, The State Of California, Santa Clara County,  
And Other Santa Clara County Cities Could Realize  
One-Time Revenues Of About \$16 Million*

The March 1991 San Jose City Auditor report included a finding entitled:

- MORE DIRECT, PERSONAL, AND COERCIVE MEANS OF TRAFFIC CITATION ENFORCEMENT COULD GENERATE AN ADDITIONAL \$4,620,000 FOR THE CITY OF SAN JOSE AND REDUCE THE NUMBER OF UNAUTHORIZED DRIVERS ON CALIFORNIA STREETS

This finding included ten (10) recommendations to address the County of Santa Clara (County) failure to collect an estimated \$58 million in traffic fines issued within San Jose's city limits.

Our re-review of uncleared traffic citations revealed the following:

- As of August 1995, the dollar value of unpaid traffic citations issued within San Jose's city limits was \$68.1 million, of which \$5.3 million was owed to the City of San Jose (City) and
- As of March 31, 1996, the County had implemented only five (5) of the 13 recommendations we made in our March 1991 audit report to improve the County's collection of unpaid traffic citations.

We also identified during our re-review that several governmental jurisdictions were successfully using private collection agencies to collect unpaid traffic citations. If the Santa Clara Municipal Court (Municipal Court) were to use a private collection agency to collect unpaid traffic citations, we estimate that the City could realize one-time revenues of \$450,000 while the State of California (State), the County, and other Santa Clara County cities could realize one-time revenues of \$9.6 million, \$5.6 million, and \$800,000, respectively. In addition, we estimate that the use of a private collection agency to collect traffic citations would increase the City's traffic citation revenues by \$160,000 per year. Furthermore, the use of a private collection agency would result in the City receiving significantly improved management reports regarding the collection of traffic citations. Finally, the Municipal Court should consider imposing a civil assessment for a Failure to Appear in accordance with Penal Code Section 1214.1.

*From 1988-89 To 1994-95, The City Of San Jose's Annual Revenue From Traffic Citations Has Declined Nearly Two-Thirds While From 1990-91 To 1994-95 The State Of California's Annual Revenue From Traffic Citations Issued Within Santa Clara County Has More Than Doubled*

Since 1991, the California legislature has passed several laws pertaining to the distribution of traffic citation revenues among the state, California's 58 counties, and various local governments. These legislative changes have all worked to the benefit of the state and to the detriment of cities. In addition, we identified during our review that while the State and County collected \$965,000 and \$2.5 million, respectively, as a result of two amnesty programs, the City did not receive any of the \$250,000 to which it was otherwise entitled. Further, we identified that from 1986 to 1994 the number of San Jose Police Department (SJPD) issued traffic citations has dropped from 148,533 per year to only 64,949 per year. Finally, we identified that from July 1, 1990, to December 31, 1995, the County made \$250,000 in unauthorized charges against the City to process the City's installment payments for misdemeanor and felony offenses. As a result, from 1988-89 to 1994-95, the City's annual revenue from traffic citations has declined from \$2,251,438 to only \$764,478. Accordingly, we recommend that the City Manager continue to work with the League of California Cities to

support legislation to correct the current inequitable distribution of traffic citation revenues among the state, counties, and local governments. We also recommend that the SJPD evaluate the Traffic Enforcement Unit's mission, staffing, equipment, deployment, and enforcement procedures relative to all service delivery activities including traffic citations and include the results of the evaluation as part of the Public Safety Augmentation Plan process. Finally, we recommend that the City Manager initiate the Dispute Resolution Process contained in the December 16, 1993, agreement between the City of San Jose and Santa Clara County to ensure compliance with Penal Code Section 1463.

**A Financial Audit Of The Santa Clara County Cities Association for the Years Ended June 30, 1994 And 1995 (June 1996)**

The Santa Clara County Cities Association (SCCCA), an unincorporated association, was established in February 1990 by the cities of Santa Clara County, California. SCCCA is a joint powers agreement among the member cities and is not a public entity separate from the parties to the agreement. The purposes and functions of SCCCA are (a) to review, study, and develop consensus positions, and recommend on issues of interest to Santa Clara County cities; (b) to develop a common agenda for Santa Clara County cities; (c) to serve as a unified voice for Santa Clara County cities in relationship to other agencies, organizations, and levels of government, including the Peninsula Division of the League of California Cities; (d) to serve as the City Selection Committee pursuant to Government Code, Section 50270 et seq., and make appointments to regional and local bodies as provided by law; (e) to assist in development of statewide legislative policy through the structure of the League of California Cities; (f) to serve as a source of education, information and networking for officials from all cities in Santa Clara County; and (g) to provide a forum for non-city individuals, groups and organizations, and the private sector to address items of interest to Santa Clara County cities.

This audit report summarizes our audit of the general fund balance sheets of SCCCA as of June 30, 1994 and 1995, and the related statements of revenues and expenditures, changes, in fund balances, and fixed assets for the years ended June 30, 1994 and 1995. This report also summarizes our findings and recommendations to improve the internal controls of SCCCA.

**An Evaluation Of The Feasibility Of The City Of San Jose  
Selling The San Jose Municipal Water System (September 1996)**

**Alternative Mechanisms To Determine The Value  
Of The System And The Net Proceeds  
Which The City Might Receive From A Sale**

A major part of our assignment was to estimate a potential sale price of the San Jose Municipal Water System (SJMWS). Accordingly, we reviewed four methods available to value the SJMWS from a sale perspective. These four methods are: (1) reproduction cost new less depreciation, (2) comparable sales, (3) capitalized earnings, and (4) rate base. Based upon our review, we concluded that rate base was the most appropriate methodology to use to value the SJMWS. After selecting the rate base methodology, we next reviewed a recently completed consultant study the SJMWS had done to calculate the cost to reproduce its assets and the value of those assets less depreciation. We used the information in that consultant study to perform an analysis, using construction indices for water utilities, to recalculate the value of the SJMWS' fixed assets. Based upon our review, we estimated the SJMWS' net fixed assets at \$56.9 million. In addition, we estimated the potential proceeds from the sale of the SJMWS to be \$40 million. This is \$9.8 million more than what the SJMWS' staff estimated in February 1995. It should be noted that our estimated \$40 million in potential SJMWS sale proceeds could be reduced by as much as \$10 million in bond refundings. In addition, the City may have to pay none, some, or all of \$3 million in sales and transaction costs.

**The Financial Benefits If The City Retains Ownership Of The System**

The SJMWS staff has noted various benefits of owning the SJMWS. Some of these benefits include: (1) providing lower water rates for customers, (2) promoting desired economic and community development, (3) enhancing the City's ability to operate the South Bay Water Recycling Project (SBWRP), and (4) allowing the City to maintain a direct role in the water supply field to obtain additional or strengthened opportunities to ensure an adequate water supply for the City's future. In addition, our review revealed the following alternative financial benefit options if the City retains ownership of the system:

- Annual revenues over the next 13 years from \$1.7 million to \$2.8 million through the adoption of a water rate policy that establishes a reasonable rate of return on SJMWS assets;
- A potential one-time transfer to the General Fund of about \$7 million in SJMWS cash reserves derived from water service charges;
- Potential bond proceeds to the General Fund for capital projects in 1996-97 of about \$22 million; and
- Over a 15 year period, the cost of water service would be less under the City's current pricing policy than it would be under private ownership.

*The Potential Of Resolving Other Major Issues Associated  
With The Sale, Such As Maintaining Access  
To Hetch Hetchy Water And Providing A Market  
For The Water Pollution Control Plant's Reclamation Project*

In order for the City to sell the SJMWS to a private entity, the sale must overcome a veritable fish ladder of potential obstacles. Failure to overcome any of these obstacles would prevent or potentially prevent the City from selling the SJMWS. These obstacles include:

- City Council required actions and voter approval at a special election;
- Resolving tax-exempt bond status issues for the City assessment district and limited refunding obligation bonds related to the SJMWS;
- Resolving Santa Clara Valley Water District and Hetch Hetchy water supply issues;
- Resolving South Bay Water Recycling Project issues; and
- Obtaining California Public Utility Commission approval.

Should the sale survive the above obstacles, we estimate that the sale would take two to three years.

## **An Audit Of The City Of San Jose's Business Tax Collection Process (December 1996)**

### **San Jose's Business Tax Program Improvements Will Increase City Revenues**

With the exception of specific San Jose Municipal Code exemptions, all persons or businesses conducting business in the City are required to pay an annual business tax. Any person or business that fails to pay its business tax in a timely manner is subject to penalties and interest. According to City Auditor quarterly reports, as of September 30, 1996, the City Auditor's Office had identified 2,309 San Jose businesses that had not paid or underpaid an estimated \$1,315,903 in business taxes. During the course of our ongoing business tax audits, we noted several systemic problems with the City's Business Tax Program that caused the City to not receive its rightful share of revenues. Specifically, we identified the following:

- the City may be able to collect \$440,978 on a one-time basis and \$187,932 annually from businesses that underreported the number of employees on their Business Tax Renewal Forms and
- the City did not receive \$11,829 in business taxes from some tenants of four skyrise buildings and two shopping malls within the city limits of San Jose.

In our opinion, the Administration should add to its workplan to implement the amnesty program the City Auditor recommended in June 1994, an amnesty program for those businesses that have underreported the number of employees on their Business Tax Renewal Form. In addition, Finance should (1) amend its Business Tax Renewal Form and (2) work with San Jose rental property managers to inform tenants of their business tax responsibilities. By so doing, the City will increase its business taxes.

## **An Audit Of The City Of San Jose's Open Purchase Order Process (December 1996)**

### **The City's Open Purchase Order Process Can Be More In Compliance With The Municipal Code As Well As More Efficient And Value Added**

The City of San Jose (City) Municipal Code (Code) authorizes the use of open purchase orders to acquire goods and services. Buyers in the City's Purchasing Division are responsible for issuing open purchase orders. In 1995-96, the City awarded approximately 2,000 open

purchase order contracts worth approximately \$40.3 million. The City Auditor's Office selected and tested for compliance with the Code and Purchasing's policies and procedures, 221 open purchase orders worth approximately \$24.7 million that Purchasing awarded in 1995-96. The results of our open purchase order tests were that 38 percent of the vendors selected and 26 percent of the dollars awarded did not appear to be in compliance with the Code and/or Purchasing's own policies and procedures.

Specifically, we identified that,

- buyers did not always obtain or adequately document that they solicited three quotations when practicable;
- the City could have saved about \$200,000 if buyers had selected the lowest quote vendor;
- buyers did not perform any product or service usage analysis when vendor selection was based upon that criteria;
- Purchasing needs to document its compliance with the Code; and
- buyers issued some open purchase orders for purposes that did not fall under the Code definition for open purchase orders.

In our opinion, the above noncompliance with Code or policy requirements is a function of the short period of time buyers have each year to process open purchase orders. This constricted time frame also causes the open purchase order process to be labor intensive paper shuffling that is not as value added as it could be.

During our audit, we also surveyed several other cities that were comparable in size to San Jose. Our survey revealed that some of these cities issue multi-year open purchase orders. Should Purchasing use multi-year open purchase orders, we estimate that the time required for Purchasing to process an open purchase order would be reduced by 86 percent. As a result, compliance with Code and policy requirements should improve and buyers should be able to concentrate on those open purchase orders that have the highest value added potential.

*Opportunities Exist To Further Improve  
The Open Purchase Order Process*

During our review of the open purchase order process, we identified several areas where additional improvements are possible. Specifically, we noted that:

- The Code is unclear regarding public works type of maintenance projects;
- Purchasing needs to provide assurance that the use of specific cooperative purchasing agreements provide the City with the best value;
- Purchasing does not always combine open purchase orders to determine reporting or approval requirements;
- Purchasing does not monitor leases or advise City departments regarding expiration dates;
- Buyers' workloads are inequitably distributed;
- Purchasing issued as many as 100 open purchase orders to the same vendor for the same commodity; and
- Purchasing's vendor lists were not current.

Purchasing can improve the efficiency and effectiveness of the open purchase order process by (1) working together with Public Works and the City Attorney's Office to clarify the distinction between public works projects and general services, (2) developing procedures for cooperative purchasing agreements and leases, (3) improving its open purchase order reporting and approval process, (4) developing buyer workload management information, (5) issuing only one open purchase order for the same commodity or service purchases from the same vendor, and (6) automating its vendor lists.

*Administrative Improvements Are Needed In Order  
To Standardize And Speed Up City Department Payments  
To Those Vendors Awarded Open Purchase Orders*

Each City department is responsible for ordering goods and services off open purchase orders and processing for payment vendor invoices for open purchase order purchases. However, our audit revealed that administrative controls over the payment of open purchase order vendor invoices need improvement. Specifically,

- vendor invoice terms could not be compared to the terms stipulated in the open purchase order award;
- City departments made unauthorized purchases;
- mathematical errors on vendor invoices went undetected;
- departments lacked adequate information to properly review invoices before making payment; and

- the City lost discounts on vendor invoices because of slow department payment processes.

We also noted that the Purchasing Chapter of the City Administrative Manual (CAM) has not been updated since 1987 and the Finance Administrative Manual (FAM) - Accounts Payable Section is out of date. In our opinion, Purchasing and Finance should update the Purchasing Chapter of the CAM. In addition, Purchasing should reduce the volume of invoices sent to the City by requiring vendors to submit summary invoices. Furthermore, the Finance Department should update the Accounts Payable section of the FAM. These improvements should facilitate the consistent, efficient and proper payment of open purchase order vendor invoices.

*The Quality And Usability Of Open Purchase Order Information  
In The City's Financial Management System Needs Improving*

An organization's computerized management information system should provide management and system users with reliable information to perform daily operations and assess organizational performance. The City installed its computerized Financial Management System (FMS) in 1989 and subsequently enhanced the FMS several times. The City's Department of Information Technology (IT) is responsible for operating and maintaining the FMS. During our audit of open purchase orders, we noted a number of deficiencies that were the direct result of the FMS' limitations. Specifically, we identified that the FMS:

- does not produce enough management information to allow the General Services Purchasing Division (Purchasing) to measure the performance of its buyers or the cost effectiveness of the open purchase order process;
- produces open purchase order reports that contain so many discrepancies and are so unreliable that Purchasing does not allow City departments to have access to these reports;
- does not produce open purchase order management reports on Minority and Women Business Enterprises (M/WBE) purchases, recycled products, multi-year contracts, goods versus services, and lost payment discounts;
- does not produce management reports that summarize City department open purchase order activity; and
- is perceived by City departments as not being user friendly and is unresponsive to their processing and information needs.

As a result, Purchasing's ability to manage the open purchase order process is impaired and City departments spend unnecessary time on open purchase order activities. Accordingly, Purchasing should (1) input City department codes into the FMS and (2) instruct those users of open purchase orders who review and approve vendor invoices to indicate "final payment" on the final invoice or receiving document. Further, IT should (1) evaluate upgrading the FMS purchasing module, (2) program the FMS to generate a report that extracts open purchase orders by department, (3) allow departments to have access to such reports, and (4) evaluate programming the FMS to generate a report which details purchase discount information. In addition, Purchasing and IT should train City department personnel who enter, retrieve, or process the FMS open purchase order information. Finally, City departments should input purchase discount information into the FMS subject to IT successfully programming the FMS to generate purchase discount reports.

**An Audit Of The City Of San Jose's Utility Billing System (April 1997)**

*By Either Improving Or Outsourcing The Utility Billing System,  
The City And Its Recycle Plus Customers Could Save  
At Least \$2.7 Million Per Year While Customer Service And Control  
Over \$46 Million In Annual City Revenues Could Be Enhanced*

In May 1991, as part of the Recycle Plus program planning process, the San Jose City Council (City Council) opted to separate the billing and revenue collection function from the service delivery function. The Administration initiated a lengthy and unsuccessful request for proposals (RFP) process to secure a vendor to maintain a Recycle Plus customer database, bill customers and collect revenues. The Administration subsequently elected to negotiate a contract with San Jose Water Company (SJWC) to print Recycle Plus bills and collect revenues while the City would develop its own Utility Billing System (UBS) for its Recycle Plus customers. Our review of the City's UBS revealed the following:

- The cost of the UBS is about \$3.7 million per year;
- As of February 1997, the City has spent \$1.5 million on hardware and software for its UBS and is contractually committed to pay an additional \$380,000;
- System limitations and procedural deficiencies precipitated the loss of database information in September 1996, that will cost the City nearly \$600,000;

- The UBS incorporates a lien process that is unduly complicated, marginally effective as a payment incentive, and costly. If the lien process were eliminated in favor of an accelerated special assessment process, delinquent customers could save nearly \$800,000 per year and Recycle Plus revenues could increase by nearly \$300,000 on a one-time basis;
- The UBS customer service function largely duplicates what the service providers do for the same customers;
- Opportunities exist for the City to combine other City billing functions with the UBS and extend the use of credit cards to its Recycle Plus program customers;
- Recycle Plus program revenues were understated by \$500,000;
- Recycle Plus program Accounts Receivable were understated by \$1.4 million as of June 30, 1996; and
- There was an unreconciled Accounts Receivable difference between the UBS database and the City's Financial Management System (FMS) of \$1.4 million.

In our opinion, the City should improve its UBS by eliminating the lien function, streamlining its customer services, consolidating City billings, accepting credit card payments, and implementing accounting and procedural changes to strengthen internal controls and provide more accurate reporting of Recycle Plus program revenues. Further, the City should evaluate the merits of either retaining or outsourcing the UBS.

Should the City opt to retain the UBS computer system then the City should:

- Finish the development of the UBS software and database system;
- Transfer operational responsibility for its computer system to the Information Technology Department (IT);
- Hire a permanent UBS Database Administrator; and
- Prepare a data system contingency plan.

By implementing the recommendations in this Finding, we estimate the City and its Recycle Plus customers could save at least \$2.7 million per year and increase Recycle Plus revenues by \$800,000 on a one-time basis.

*The General Fund Contributed \$1.2 Million  
More Than Needed For Low-Income And  
Disability Rate Subsidies During 1994-95 And 1995-96*

The UBS administers several subsidy programs for its Recycle Plus customers including low-income rate assistance, subsidized on-premise collection for people with disabilities, fee exemptions in cases of illness, death, or if the premises is uninhabitable, and reduced rates based on a medical condition which results in the generation of a significant amount of medical waste. The General Fund annually transfers funds to the Integrated Waste Management (IWM) Fund to cover the subsidies. During 1994-95 and 1995-96, the General Fund transferred \$1 million per year to the IWM Fund. However, subsidy usage over that two year period was only \$787,000. As a result, the General Fund contributed \$1.2 million too much to the IWM Fund. In our opinion, the IWM Fund should transfer the excess back to the General Fund. In addition, Finance should periodically review subsidy usage and transfer subsidy amounts from the General Fund to the IWM Fund on a cost-reimbursement basis.

**An Audit Of The City Of San Jose's Housing Rehabilitation Program (April 1997)**

*The Housing Department Needs To Implement Procedures  
To Improve Internal Control, Document Rehabilitation Projects,  
And Enhance Program Effectiveness*

The Housing Rehabilitation Program provides the financial and technical expertise necessary to enable lower- to moderate-income families in San Jose to live in decent, safe, and sanitary housing. In September 1992, the City Auditor issued *An Assessment Of The Housing Department's Controls Over Its Housing Rehabilitation Programs*. In this audit report, we identified over 200 "threats" (any unwanted event or occurrence) confronting Housing's Rehabilitation Program and over 400 controls or procedures to prevent or mitigate those threats. As a result of our 1992 audit, Housing incorporated the identified controls and procedures into the Rehabilitation Program Handbook. However, our follow-up audit of Housing's Rehabilitation Program disclosed that Housing did not have any written procedures or other written instructions for 40 of the 112 rehabilitation projects in our sample.

Specifically, Housing does not have written procedures or instructions for grant rehabilitation projects.

Further, our audit revealed that from 1992-93 through 1995-96 Housing:

- Increased the maximum amount for a rehabilitation grant project from \$3,000 to \$7,500;
- Increased the number of rehabilitation grants per year from 2 to 180; and
- Increased the amount awarded for rehabilitation grant projects from \$57,362 to \$1,191,133.

As a result, Housing does not have any written procedures or written instructions for a significant segment of its Rehabilitation Program. Accordingly, Housing should incorporate into its Rehabilitation Program Handbook written procedures for reviewing and approving grant applications, for obtaining property owner approvals of proposed and completed rehabilitation work, and for competitively selecting contractors for grant rehabilitation projects. In addition, Housing should use recoverable home repair grants as a means to accommodate both the needs of lower-income property owners and the Rehabilitation Program's need to roll over Housing funds for future projects.

Further, our compliance testing of Rehabilitation Loan projects and Paint grant projects for which Housing has written procedures are summarized below:

**SUMMARY OF 40 REHABILITATION LOAN PROJECTS TESTED  
FOR COMPLIANCE WITH REHABILITATION  
PROGRAM WRITTEN PROCEDURES**

<b>Rehabilitation Program Handbook Procedure/Policy Tested</b>	<b>Number of Projects in Compliance</b>	<b>Number of Projects Not in Compliance</b>	<b>% of Total Projects (40) Not in Compliance</b>
Staff are required to indicate the date and initial the required items on the documentation checklist as they are completed.	26	14	35%
Income verification for each applicant consists of current paystubs, income tax returns, and W-2 forms for the past two years from all members of the household.	37	3	8%
Staff are required to prepare a work write-up and cost estimate, and the owner of the property to be rehabilitated must approve the work write-up.	34	6	15%
Competitive selection of contractors.	34	6	15%

**SUMMARY OF 32 REHABILITATION PAINT GRANT PROJECTS  
TESTED FOR COMPLIANCE WITH REHABILITATION  
PROGRAM WRITTEN PROCEDURES**

<b>Rehabilitation Program Handbook Procedure/Policy Tested</b>	<b>Number of Projects in Compliance</b>	<b>Number of Projects Not in Compliance</b>	<b>% of Total Projects (32) Not in Compliance</b>
Staff are required to indicate the date and initial the required items on the documentation checklist as they are completed.	20	12	38%
Income verification for each applicant consists of current 1040 from all members of the household.	30	2	6%
The Notice of Completion (NOC) must be signed by the owner upon completion of the project.	31	1	3%

In addition, we found that of the 67 projects that required final permits from the City of San Jose or the State of California, such permits were not on file for 15 projects. Further, we found that Housing did not complete annual recertifications of affordability restrictions for the two projects in our sample for which such certifications were required. We also found that Housing did not have complete documentation of required licenses or proofs of insurance for any of the 20 contractors we reviewed.

Further, we observed numerous instances of rehabilitation project contractors rendering poor quality and costly work resulting in dissatisfied Rehabilitation Program loan and grant recipients.

According to Housing management, Housing should not be held accountable for the poor customer service for the rehabilitation projects we identified. Further, Housing management contends that it cannot correct problems about which it does not know. However, in our opinion, had Rehabilitation Inspectors and other Housing staff performed required inspections and adequately documented the results of their inspections, Housing should have known about the rehabilitation project problems we identified.

Finally, Housing experienced significant budget and staff reductions beginning in 1993-94. Housing endured these budget and staff reductions without commensurate reductions in rehabilitation project workloads.

We recommend that Housing follow the written procedures in the Rehabilitation Program Handbook, add several new procedures to the Rehabilitation Handbook and submit a budget proposal to the City Council to provide the staff and resources necessary to implement the recommendations in this Finding.

By so doing, Housing will improve compliance with its own policies and procedures, reduce the risk that rehabilitation work will be of poor quality or too costly, enhance the Housing Rehabilitation Program's effectiveness, and improve the condition of the City of San Jose's very low- to moderate-income housing stock.

*Opportunities Exist For Housing To Improve The Reliability  
And Usefulness Of Its Rehabilitation Program  
Management Information*

Housing formally reports on the timeliness of rehabilitation projects in the City's annual operating budget. Our review of Housing's Rehabilitation Program management information revealed that Housing:

- Does not measure the timeliness of each type of rehabilitation project;
- Does not measure the timeliness of the entire rehabilitation process;
- Does not periodically review backlogged rehabilitation projects; and
- Has not documented its Rehabilitation Program database standards.

In our opinion, Housing should: (1) establish timeliness standards for all types of rehabilitation projects starting with the initial interview date, (2) periodically review rehabilitation projects delayed beyond established time objectives, and (3) document its standards and controls over the Rehabilitation Program database. By so doing, Housing will improve the reliability and usefulness of its Rehabilitation Program management information.

*Housing Needs To Update And Improve Its  
Rehabilitation Program Application Packets*

Housing provides prospective rehabilitation grant or loan recipients with an application packet. Our review of the application packet revealed that it is out-of-date and printed only in English. In our opinion, Housing needs to update the information in the application packet and print the information in other languages common to San Jose.

**A Review Of The City Of San Jose's Commercial Solid Waste Franchise And AB 939 Fees  
(June 1997)**

*Needed Modifications To Commercial  
Solid Waste Franchise And Source Reduction And  
Recycling Fees Would Increase General Fund Revenues  
By \$1.4 Million To \$2.8 Million, And Increase Integrated  
Waste Management Fund Revenues By \$0.5 Million*

In July 1996, the City of San Jose (City) changed its method of charging commercial solid waste (CSW) franchise, and source reduction and recycling (AB 939) fees, from a gross receipts basis to a volume basis. However, our review revealed that the Environmental Service Department miscalculated the rates necessary to achieve the adopted 1996-97 budget. Although these foregone revenues have been partially offset by \$1.5 million in one-time carryover revenues from 1995-96, we estimate that the General Fund and the IWM Fund will forego approximately \$1.4 million and \$0.6 million, respectively, in 1996-97. In our opinion, in order to avoid similar foregone revenues in 1997-98, the Administration should propose a rate structure that will maintain the revenue base with regards to franchise fees. In addition, the Administration should propose a rate structure that will produce the amount of AB 939 revenues shown in the 1997-98 Fees and Charges Report. We estimate this would increase 1997-98 General Fund and IWM Fund revenues by approximately \$1.4 million and \$0.5 million, respectively. In addition, we recommend the City Council consider assessing additional fees to recover the \$1.4 million in foregone 1996-97 General Fund revenue. As a result of these changes, we estimate that the General Fund could realize an additional \$1.4 million to \$2.8 million, and the IWM Fund could realize an additional \$0.5 million in 1997-98.

## APPENDIX A

### SUMMARY OF STATEMENT ON GOVERNMENT AUDITING STANDARDS

Excerpted from *Government Auditing Standards*, 1994 Revision, issued by the  
Comptroller General of the United States.

#### Introduction

<b>Purpose</b>	<p>(1) This statement contains standards for audits of government organizations, programs, activities, and functions, and of government funds received by contractors, nonprofit organizations, and other nongovernment organizations.</p> <p>(2) The standards, often referred to as generally accepted government auditing standards (GAGAS), are to be followed by auditors and audit organizations when required by law, regulation, agreement, contract, or policy.</p>
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#### Types of Government Audits

<b>Financial Audits</b>	<p>(1) <b>Financial statement audits</b> provide reasonable assurance about whether the financial statements of an audited entity present fairly the financial position, results of operations, and cash flows in conformity with generally accepted accounting principles.</p> <p>(2) <b>Financial related audits</b> include determining whether (a) financial information is presented in accordance with established or stated criteria, and (b) the entity has adhered to specific financial compliance requirements, or (c) the entity's internal control structure over financial reporting and/or safeguarding assets is suitably designed and implemented to achieve the control objectives.</p>
<b>Performance Audits</b>	<p>(1) <b>Economy and efficiency audits</b> include determining (a) whether the entity is acquiring, protecting, and using its resources (such as personnel, property, and space) economically and efficiently, (b) the causes of inefficiencies or uneconomical practices, and (c) whether the entity has complied with laws and regulations concerning matters of economy and efficiency.</p> <p>(2) <b>Program audits</b> include determining (a) the extent to which the desired results or benefits established by the legislature or other authorizing body are being achieved, (b) the effectiveness of organizations, programs, activities, or functions, and (c) whether the entity has complied with laws and regulations applicable to the program.</p>

Types of Government Audits (Cont.)

<p><b>Other Activities of an Audit Organization</b></p>	<p>Auditors may perform services other than audits. For example, some auditors may (a) assist a legislative body by developing questions for use at hearings; (b) develop methods and approaches to be applied in evaluating a new or a proposed program; (c) forecast potential program outcomes under various assumptions without evaluating current operations; and (d) perform investigative work.</p>
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General Standards

<p><b>Qualifications</b></p>	<p>The staff assigned to conduct the audit should collectively possess adequate professional proficiency for the tasks required.</p>
<p><b>Independence</b></p>	<p>In all matters relating to the audit work, the audit organization and the individual auditors, whether government or public, should be free from personal and external impairments to independence, should be organizationally independent, and should maintain an independent attitude and appearance.</p>
<p><b>Due Professional Care</b></p>	<p>Due professional care should be used in conducting the audit and in preparing related reports.</p>
<p><b>Quality Control</b></p>	<p>Each audit organization conducting audits in accordance with these standards should have appropriate internal quality control system in place and undergo an external quality control review.</p>

Field Work Standards for Financial Audits

<p><b>Planning</b></p>	<p>The work is to be properly planned, and auditors should consider materiality, among other matters, in determining the nature, timing, and extent of auditing procedures and in evaluating the results of those procedures.</p>
<p><b>Follow-up of previous findings and recommendations</b></p>	<p>Auditors should follow up on known material findings and recommendations from previous audits.</p>

Field Work Standards for Financial Audits (Cont.)

<b>Irregularities, Illegal Acts, and Other Noncompliance</b>	<p>(a) Auditors should design the audit to provide reasonable assurance of detecting irregularities that are material to the financial statements.</p> <p>(b) Auditors should design the audit to provide reasonable assurance of detecting material misstatements resulting from direct and material illegal acts.</p> <p>(c) Auditors should be aware of the possibility that indirect illegal acts may have occurred. If specific information comes to the auditors' attention that provides evidence concerning the existence of possible illegal acts that could have a material indirect effect on the financial statements, the auditors should apply audit procedures specifically directed to ascertaining whether an illegal act has occurred.</p> <p>(d) Auditors should design the audit to provide reasonable assurance of detecting material misstatements resulting from noncompliance with provisions of contracts or grant agreements that have a direct and material effect on the determination of financial statement amounts. If specific information comes to the auditors' attention that provides evidence concerning the existence of possible noncompliance that could have a material indirect effect on the financial statements, auditors should apply audit procedures specifically directed to ascertaining whether that noncompliance has occurred.</p>
<b>Internal Controls</b>	Auditors should obtain a sufficient understanding of internal controls to plan the audit and determine the nature, timing, and extent of tests to be performed.
<b>Working Papers</b>	<p>(a) A record of the auditors' work should be retained in the form of working papers.</p> <p>(b) Working papers should contain sufficient information to enable an experienced auditor having no previous connection with the audit to ascertain from them the evidence that supports the auditors' significant conclusions and judgments.</p>

## Reporting Standards for Financial Audits

<p><b>Communication with Audit Committees or Other Responsible Individuals</b></p>	<p>Auditors should communicate the following information related to the conduct and reporting of the audit to the audit committee or to the individuals with whom they have contracted for the audit: (a) the auditors' responsibilities in a financial statement audit, including their responsibilities for testing and reporting on internal controls and compliance with laws and regulations, and (b) the nature of any additional testing of internal controls and compliance required by laws and regulations.</p>
<p><b>Reporting Compliance with Generally Accepted Government Auditing Standards</b></p>	<p>Audit reports should state that the audit was made in accordance with generally accepted government auditing standards.</p>
<p><b>Reporting Compliance with Laws and Regulations and on Internal Controls</b></p>	<p>The report on the financial statements should either (1) describe the scope of the auditors' testing of compliance with laws and regulations and internal controls and present the results of those tests or (2) refer to separate reports containing that information. In presenting the results of those tests, auditors should report irregularities, illegal acts, other material noncompliance, and reportable conditions in internal controls. In some circumstances, auditors should report irregularities and illegal acts directly to parties external to the audited entity.</p>
<p><b>Privileged and Confidential Information</b></p>	<p>If certain information is prohibited from general disclosure, the audit report should state the nature of the information omitted and the requirement that makes the omission necessary.</p>
<p><b>Report Distribution</b></p>	<p>Written audit reports are to be submitted by the audit organization to the appropriate officials of the auditee and to the appropriate officials of the organizations requiring or arranging for the audits, including external funding organizations unless legal restrictions prevent it. Copies of the reports should also be sent to other officials who have legal oversight authority or who may be responsible for acting on audit findings and recommendations and to others authorized to receive such reports. Unless restricted by law or regulation, copies should be made available for public inspection.</p>

## Field Work Standards for Performance Audits

<b>Planning</b>	Work is to be adequately planned. In planning, auditors should define the audit's objectives and the scope and methodology to achieve those objectives.
<b>Supervision</b>	Staff are to be properly supervised. Supervision involves directing the efforts of auditors and others who are involved in the audit to determine whether the audit objectives are being accomplished. Elements of supervision include instructing staff members, keeping informed of significant problems encountered, reviewing the work performed, and providing effective on-the-job training.
<b>Compliance with laws and regulations</b>	When laws, regulations, and other compliance requirements are significant to audit objectives auditors should design the audit to provide reasonable assurance about compliance with them. In all performance audits, auditors should be alert to situations or transactions that could be indicative of illegal acts or abuse.
<b>Management Controls</b>	Auditors should obtain an understanding of management controls that are relevant to the audit. When management controls are significant to audit objectives, auditors should obtain sufficient evidence to support their judgments about those controls.
<b>Evidence</b>	Sufficient, competent, and relevant evidence is to be obtained to afford a reasonable basis for the auditors' findings and conclusions. A record of the auditors' work should be retained in the form of working papers. Working papers should contain sufficient information to enable an experienced auditor having no previous connection with the audit to ascertain from them the evidence that supports the auditors' significant conclusions and judgments.

<b>Validity and Reliability of Data From Computer-Based Systems</b>	<p>Auditors should obtain sufficient, competent, and relevant evidence that computer-processed data are valid and reliable when those data are significant to the auditors' findings. This work is necessary regardless of whether the data are provided to auditors or auditors independently extract them. Auditors should determine if other auditors have worked to establish the validity and reliability of the data or the effectiveness of the controls over the system that produced the data. If they have, auditors may be able to use that work. If not, auditors may determine the validity and reliability of computer-processed data by direct tests of the data. Auditors can reduce the direct tests of the data if they test the effectiveness of general and application controls over computer-processed data, and these tests support the conclusion that the controls are effective.</p>
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Reporting Standards for Performance Audits

<b>Form</b>	<p>Auditors should prepare written audit reports communicating the results of each audit. Written reports (1) communicate the results of audits to officials at all levels of government, (2) make the results less susceptible to misunderstanding, (3) make the results available for public inspection, and (4) facilitate follow-up to determine whether appropriate corrective actions have been taken. The need to maintain public accountability for government programs demands that audit reports be written.</p>
<b>Timeliness</b>	<p>Auditors should appropriately issue the reports to make the information available for timely use by management, legislative officials, and other interested parties.</p>
<b>Objectives, Scope, and Methodology</b>	<p>Auditors should report the audit objectives and the audit scope and methodology.</p>
<b>Audit Results</b>	<p>Auditors should report significant audit findings, and where applicable, auditors' conclusions.</p>
<b>Recommendations</b>	<p>Auditors should report recommendations for actions to correct problem areas and to improve operations.</p>
<b>Statement on Auditing Standards</b>	<p>Auditors should report that the audit was made in accordance with generally accepted government auditing standards.</p>

<b>Compliance With Laws and Regulations</b>	Auditors should report all significant instances of noncompliance and all significant instances of abuse that were found during or in connection with the audit. In some circumstances, auditors should report illegal acts directly to parties external to the audited entity.
<b>Management Controls</b>	Auditors should report the scope of their work on management controls and any significant weaknesses found during the audit.
<b>Views of Responsible Officials</b>	Auditors should report the views of responsible officials of the audited program concerning auditors' findings, conclusions, and recommendations, as well as corrections planned.
<b>Noteworthy Accomplishments</b>	Auditors should report noteworthy accomplishments, particularly when management improvements in one area may be applicable elsewhere.
<b>Issues Needing Further Study</b>	Auditors should refer significant issues needing further audit work to the auditors responsible for planning future audit work.
<b>Privileged and Confidential Information</b>	If certain information is prohibited from general disclosure, auditors should report the nature of the information omitted and the requirement that makes the omission necessary.
<b>Report Presentation</b>	The report should be complete, accurate, objective, convincing, and as clear and concise as the subject permits.
<b>Report Distribution</b>	Written audit reports are to be submitted by the audit organization to the appropriate officials of the auditee and to the appropriate officials of the organizations requiring or arranging for the audits, including external funding organizations, unless legal restrictions prevent it. Copies of the reports should also be sent to other officials who have legal oversight authority or who may be responsible for acting on audit findings and recommendations and to others authorized to receive such reports. Unless restricted by law or regulation, copies should be made available for public inspection.

APPENDIX B  
OFFICE OF THE CITY AUDITOR  
CITY COUNCIL APPROVAL OF ASSIGNMENT PROCEDURE

<u>Responsibility</u>	<u>Action</u>
<b><i>City Auditor</i></b>	1. Prior to the beginning of the next fiscal year, submit to the Finance Committee a proposed Audit Workplan.
<b><i>Finance Committee</i></b>	2. Review and recommend City Auditor audit assignments for the next fiscal year and forward recommended City Auditor audit assignments to the City Council.
<b><i>City Council</i></b>	3. Review and approve Finance Committee recommended City Auditor audit assignments.
<b><i>City Council Members and City Manager</i></b>	4. Submit requests for City Auditor services to the Rules Committee.
<b><i>Rules Committee</i></b>	5. Forward request to City Auditor.
<b><i>City Auditor</i></b>	6. Review request. Respond to Rules Committee at next meeting. Response to include: availability of staff and resources, any external time constraints relative to the requested assignment, and other factors the City Auditor deems important.
<b><i>Rules Committee</i></b>	7. Review the City Auditor's response. Approve or disapprove the requested assignment.
	8. Communicate the decision to the City Auditor, the City Council, and the assignment requestor.
<b><i>City Auditor</i></b>	9. Initiate the assignment as soon as staff become available.
	10. Report monthly to the Rules Committee and to the Finance Committee the status of approved audit assignments.
<b><i>City Manager, City Attorney, or City Clerk</i></b>	11. Request City Auditor's services when an emergency situation exists.

***City Auditor***

12. Respond immediately when the request regards an emergency situation.
13. Report to the Rules Committee at its next meeting. Report will include: any requests for immediate response received, what action was taken, and the disposition of the request.

APPENDIX C

OFFICE OF THE CITY AUDITOR  
CITY OF SAN JOSE  
QUALITY CONTROL REVIEW FOR  
THE 24 MONTHS ENDED JUNE 30, 1997  
(INDEPENDENT AUDITOR'S REPORT)

# NALGA

National Association of Local Government Auditors

NALGA Peer Review Committee  
1220 SW Fifth Ave., Room 120  
Portland, OR 97204  
(503) 823-3542

November 20, 1997

Honorable Mayor and Members  
of the City Council  
801 North First Street, Room 600  
San Jose, California 95110

Attached is the audit report of an external quality control review of the Office of the City Auditor for audits issued during the period May 1, 1995 through June 30, 1997. In conducting our review, we followed the standards and guidelines contained in the National Association of Local Government Auditors' Review Guide published in 1995.

The report includes the auditors' opinion stating that the Office of the City Auditor conducted audits in accordance with Government Auditing Standards the management letter, and the Office of the City Auditor's response to the Management letter.

The audit was performed by representatives of the National Association of Local Government Auditors. Mr. David Jones, Senior Auditor from Seattle, Washington, and a member of the quality control review team will present this report to the Finance Committee at its December 10, 1997 meeting.

Respectfully submitted,



Richard Wallace, CPA  
Principal Auditor  
City of Jacksonville, Florida

RW/ml

rw:sanjose

DEC 02 1997

CITY OF JACKSONVILLE

**CITY OF SAN JOSE' CALIFORNIA  
EXTERNAL QUALITY  
CONTROL REVIEW  
For the Period May 1, 1995  
through June 30, 1997**

**Issued  
November 7, 1997**

# NALGA

National Association of Local Government Auditors

NALGA Peer Review Committee  
1220 SW Fifth Ave., Room 120  
Portland, OR 97204  
(503) 823-3542

November 7, 1997

Honorable Mayor and Members  
of the City Council  
801 N. First Street, Room 600  
San Jose, California 95110

Dear Mr. Silva:

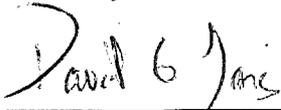
We have completed an external quality control review of the Office of the City Auditor for the City of San Jose for audits issued during the period May 1, 1995 through June 30, 1997. In conducting our review, we followed the standards and guidelines contained in the NALGA Quality Control Review Guide (NALGA Guide) published in May 1995, by the National Association of Local Government Auditors.

As prescribed by the NALGA Guide, we reviewed the internal quality control system of the Office of the City Auditor and tested a sample of audits conducted by that office for compliance with government auditing standards issued by the Comptroller General of the United States (Government Auditing Standards, 1994 Revision). Due to variance in individual performance and judgment, compliance does not imply adherence to standards in every case, but does imply adherence in most situations.

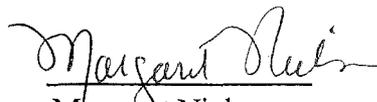
We have concluded from our review that your system of internal quality control was suitably designed and provided reasonable assurance that applicable government auditing standards were followed in your audit work. We have also concluded from the sample of audits tested that your quality controls were working effectively and that audits were conducted in conformance with applicable standards during the period under review. This review will complete the achievement of all requirements for compliance with government auditing standards, consequently, all future audit reports may include a statement that the audit was performed in compliance with government auditing standards.

It is our opinion, therefore, that the Office of the City Auditor for the City of San Jose was in compliance with government auditing standards during the period May 1, 1995 through June 30, 1997. We have prepared and enclosed herewith a separate letter offering suggestions which, in our opinion, will further increase the value of the Office of the City Auditor to the City of San Jose.

Sincerely,



David Jones  
Senior Auditor  
City of Seattle, Washington



Margaret Nielson  
Performance Auditor  
City of Austin, Texas



Richard Wallace  
Principal Auditor  
City of Jacksonville, Florida

# **NALGA**

National Association of Local Government Auditors

NALGA Peer Review Committee  
1220 SW Fifth Ave., Room 120  
Portland, OR 97204  
(503) 823-3542

November 7, 1997

Gerald A. Silva, City Auditor  
Office of the City Auditor  
800 N. First Street  
San Jose, California 95110

Dear Mr. Silva:

We have completed an external quality control review of the Office of the City Auditor for the City of San Jose for audits issued during the period May 1, 1995 through June 30, 1997. We have issued a report stating our opinion that the Office of the City Auditor was in compliance with Government Auditing Standards. We are presenting you with this companion letter offering additional observations and some suggestions which, in our opinion, will further increase the value of the City Auditor to the City of San Jose.

First, the following are some areas where, in our opinion, your office excelled:

- The Office has performed audits of challenging and complex topics using sophisticated analytical techniques. Furthermore, these audits have resulted in many recommendations which have been accepted by management.
- The Office's reports contain positive comments regarding auditees' noteworthy accomplishments.
- The Office appears to have a well-developed follow-up process to check implementation of recommendations and report on their status.
- The Office should be commended for its exhaustive efforts during the survey phase to identify potential program risks and management controls which could mitigate these risks.
- The Office has established an extensive quality assurance process which features a specific review of adherence to Government Auditing Standards and an independent report review.

As the above comments indicate, we observed that your office has many strengths. We would like to offer the following comments and suggestions which may improve your operations and better demonstrate your compliance with Government Auditing Standards.

## **Follow-up to the prior review**

We followed up on previous management letter comments regarding timeliness as it relates to the estimated completion date of the audit and the actual audit release date. We found that although timeliness does not appear to have improved, this may be, in part, due to the measure used.

The Office should consider using different measures and providing explanations for changes in the estimated completion date of a report (e.g., scope expansion or reassignment of staff to urgent priorities). Because of the nature of performance audits, the Office may also decide not to release an estimated completion date until closer to the completion of the audit.

### **Compliance with internal procedures**

- The Office's self-imposed Audit Standards Reviews were not consistently done at the intervals prescribed in office procedures. It was not clear if all the intended benefit was achieved when reviews were done at the completion of the audit, rather than at the earlier checkpoints prescribed by policy.
- The Office can improve its documentation of reasons for not performing all prescribed office procedures. Specifically, audit working papers should not only document the City Auditor's concurrence with not performing all prescribed audit procedures but the audit supervisor should also include written explanatory information as to why it was not necessary to perform all prescribed procedures.
- Some key documents, although generally produced upon request, were not present in the official working paper files. For example, some documents were reproduced from electronic files, others from office correspondence files or audit staff files. Examples included the original "Audit Program and Results" for the audit, and a key memorandum stating objectives of the audit.
- In one instance, key decisions made as a result of the preliminary survey work could have been more clearly documented in the official working paper files.

### **Evidence of compliance with standards and internal procedures**

- Although adequacy of staff training was ultimately verified, documentation to support compliance with Continuing Professional Education requirements was not readily accessible.
- Office policies and procedures (e.g., the Audit Standards Plan) did not clearly incorporate the 1994 Government Auditing Standards revisions.
- While in general the office adequately documents adherence to standards, we did note instances where evidence supporting adherence to standards could be clearer. For example:
  - \* The manner in which previous audit work was considered could be better documented in the working papers,
  - \* consideration of illegal acts, abuse, and instances of non-compliance could be better explained in working papers,
  - \* disposition of issues for future audit or study could be better indicated in the working papers and/or report,
  - \* reporting on the scope of management controls audited could be more explicit.

The Office should consider using different measures and providing explanations for changes in the estimated completion date of a report (e.g., scope expansion or reassignment of staff to urgent priorities). Because of the nature of performance audits, the Office may also decide not to release an estimated completion date until closer to the completion of the audit.

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- In one instance, key decisions made as a result of the preliminary survey work could have been more clearly documented in the official working paper files.

### **Evidence of compliance with standards and internal procedures**

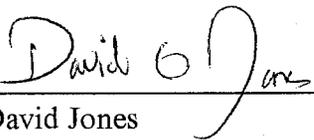
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  - \* The manner in which previous audit work was considered could be better documented in the working papers,
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  - \* disposition of issues for future audit or study could be better indicated in the working papers and/or report,
  - \* reporting on the scope of management controls audited could be more explicit.

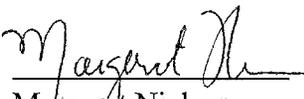
**Report format**

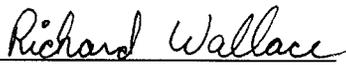
In one instance, the statements of scope could have been broadened to more clearly define any limitations related to the computer system tested. Specifically, the scope could include a description of what procedures the office followed to compensate for any computer systems testing limitations.

We hope that the above comments assist you in continuing the professional work we observed during the review. We appreciate the hospitality and cooperation extended by your staff during our stay in San Jose.

Sincerely,

  
\_\_\_\_\_  
David Jones  
Senior Auditor  
City of Seattle, Washington

  
\_\_\_\_\_  
Margaret Nielson  
Audit Manager  
City of Austin, Texas

  
\_\_\_\_\_  
Richard Wallace  
Principal Auditor  
City of Jacksonville, Florida

rw:silva2



# CITY OF SAN JOSÉ, CALIFORNIA

800 N. First Street • San Jose, California 95112 • Tel: (408) 277-4601

GERALD A. SILVA  
City Auditor

November 20, 1997

Mr. Richard Wallace, Principal Auditor  
220 East Bay Street, Room 1103  
Jacksonville, Florida 32202

Dear Mr. Wallace:

The Office of the City Auditor submits the following comments in response to the audit of its operations.

I am pleased that the independent auditors did not find any significant weaknesses in the Office of the City Auditor's (Office) internal quality control system. The auditors stated that our system of internal control provided reasonable assurance of compliance with generally accepted government auditing standards and met the objectives of the National Association of Local Government Auditors quality control guidelines during the period audited.

I am also extremely gratified that in the management letter the auditors noted a number of areas that the Office excels. These areas include:

- The Office uses sophisticated auditing techniques to perform complex and challenging audits.
- Audit reports contain positive comments regarding the auditees' noteworthy accomplishments.
- The Office has a well-developed follow up process to ensure recommendations are implemented.
- The Office undergoes exhaustive efforts to identify potential program risks and management controls to mitigate these risks.
- The Office has an extensive quality assurance process.



Mr. Richard Wallace  
November 20, 1997  
Page 2

The management letter also noted several comments and suggestions to improve the Office's operations and better demonstrate compliance with Government Auditing Standards. Overall, the Office concurs with all of these suggestions and will take appropriate steps to implement them. With regard to the issue of the timeliness of audit reports, the Office has the following comments.

**Comments on the timeliness of audits**

In the management letter, the auditors note that timeliness does not appear to have improved; however, this problem may be in part be due to the measure used. The auditors suggested that the Office should consider using different measures and providing explanations for changes in the estimated completion date of a report.

As the auditors observed, the Office has established a rigorous audit planning, monitoring, and time-reporting system to estimate the completion dates of audits. The Office uses this information to estimate the completion date as early as possible during the audit. Nevertheless, predicting audit completion dates is more art than science. As the auditors note, a number of factors can significantly affect the completion date. These factors include: scope changes, other audit priorities, slow responses from auditees, and staff turnover. Thus, the auditors' suggestion to consider using different methods to keep the City Council informed of the status of audits is very sensible. Accordingly, the Office will work with the Finance Committee to develop a new reporting format that keeps the City Council adequately informed on the status of audits and provides reasonable expectations on their completion dates.

The City Auditor's Office is committed to continuously improving and refining its audit processes. As such, we welcome the auditors' review and insights. We think that those insights and perspectives will be helpful in improving the Office's work. We also wish to thank the auditors, Richard Wallace, Margaret Nielson, and David Jones for the professionalism, openness, and courtesy they displayed during this audit.

Sincerely,



Gerald A. Silva  
City Auditor

0550E  
GS:bh

cc: Margaret Nielson  
David Jones