



THE CITY OF SAN DIEGO

MEMORANDUM

DATE: April 29, 2011

TO: Honorable Council President Pro Tem Kevin Faulconer, Chair, Audit Committee
Audit Committee Members

FROM: Mary Lewis, Chief Financial Officer *Mary Lewis*

SUBJECT: Revenue Recovery Auditing

This memorandum summarizes the status of the review of revenue recovery activities. As stated on several occasions to the Audit Committee, I agree that additional revenue recovery audits have merit and options are being reviewed. The finance departments have been evaluating the potential benefit to the City and the timing of implementing these programs. Adding certain focused audits to the City's current revenue recovery program has also been discussed with the City Auditor and we have responded in writing regarding our plans to implement additional audits. These include management's responses to prior audit report recommendations and are included in the discussion below.

This memorandum covers potential audits of Accounts Payable, Reverse Sales Tax and Superior Court fees. In addition, the City Treasurer has issued a memorandum dated April 28, 2011 on the use of third party collection agencies for the City's delinquent accounts receivables and possible steps to be taken to supplement revenue by working inactive accounts.

This memorandum covers the three areas of Account Payable, Reverse Sales Tax and Superior Court Fees.

Accounts Payable

Accounts payable audits are performed to identify activity such as overpayments, payments for services not rendered, duplicate payments and to identify unutilized credits from vendors.

City management has stated that it will engage a third party accounts payable recovery auditing specialist to review our paid records in SAP for duplicate payments. This representation was made in our response 5a to the audit findings in the Audit of the Enterprise Resource Planning System Implementation issued by the Office of the City Auditor in January 2011. This is an excerpt of our response addressing this issue:

" 5a. We propose that a more effective approach is to hire a Payments Auditing Company to review for duplicate payments against a dataset of all of the invoice documents processed in SAP since its implementation date. This would occur after our efforts to cleanse the vendor master dataset of all duplicate vendors (see response to recommendation #5b and #5c). The external audit would be completed by June 2012."

Reverse Sales Tax

Reverse Sales Tax audits identify where the City paid taxes where it is exempted.

The City responded to two audit findings concerning tax paid on chemicals that could have been partially exempt from tax because they were used as additives to wastewater which was resold to customers. These responses were to findings 1 and 2 of the Metropolitan Wastewater Department Contract Compliance Audit. While there are few instances of products that the City produces and sells to a third party which would allow us any sales tax exemption, there is a possibility that the City could pay sales tax on pass through products that may be tax exempt. We will include Reverse Sales Tax recovery procedures with the Accounts Payable Recovery Audit that is planned for by June 2012.

Municipal Court Fees

The City Treasurer has responded to the City Auditor on this audit recommendation.

On March 5, 2010, the Office of the City Auditor issued a *Citywide Revenue Audit Report* (Audit Report), which included the following recommendation:

Recommendation #15: “The City Treasurer’s Office Revenue Audit Division should consider performing audits of court-distributed revenues.”

On March 8, 2010, the Chief Financial Officer provided a response to the Office of the City Auditor (memorandum *Management Response to the Citywide Revenue Audit Report*). Management agreed that a cost-benefit analysis would be done to determine whether such an audit would be an effective use of its resources.

When completing the analysis, the City Treasurer’s Office evaluated the total revenue received from the County as well as the cost to the City of conducting an audit of these revenues. Additionally, they considered the possibility of outsourcing an audit of court distributed revenue on a contingency basis.

Although the City Auditor reported in the *Citywide Revenue Audit Report* that the Fine, Forfeiture, and Penalty revenue was \$118 million for FY 2007 through FY 2009, actual payments received from the County for this period totaled \$26 million. The remaining \$92 million was revenue received directly from citizens for charges such as parking citations and collection referral fees and penalties. That revenue is audited by the City Auditor in their departmental audits.

The City Attorney’s Office has advised that an audit of the County’s remittances would be limited to a three-year audit period. The court fees paid to the City from FY 2008 through FY 2010 totaled approximately \$26.3 million. Based on the State’s prior audit of the County which resulted in a finding requiring a \$541,000 payout to the City, we estimate a potential recovery of one (1%) percent, or \$263,000.

In order to assess potentially engaging an outside firm to conduct contingency-based auditing services, two firms specializing in government revenue recovery were contacted, HdL Companies

and MuniServices. HdL Companies stated it does not perform this type of audit and MuniServices indicated that, although it has performed court fee audits, it would not perform such an audit on a contingency basis. To conduct this type of audit, MuniServices would charge a contract rate of approximately \$125 per hour.

The Office of the City Treasurer Revenue Audit Program will conduct an audit of the County's court fee revenues in FY 2012. The audit will be performed by existing staff and therefore will not result in additional hard costs to the City, although there will be some lost revenue in the reassignment of audit focus. To conduct the audit, an auditor who is working full time on TOT and lease rent audits will be reassigned for approximately 300 hours. This will result in a loss of TOT/lease rent revenue recovery, but the potential to recover more from the audit of court fees outweighs the loss of TOT/lease rent.

It was also noted in the March 2010 Audit Report that the City Treasurer does not receive detailed payment remittance advice from the County. As with all City departments, it is the issuing department's responsibility to reconcile their revenues. Without detailed payment information from the County, the department cannot reconcile incoming revenue to the revenue generating document (i.e. infraction citation). The City Comptroller will work with the affected issuing departments to create and implement Process Narratives to establish procedures to obtain the detailed payment remittance information from the County and to reconcile incoming City revenue.

Mary Lewis
Chief Financial Officer

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cc: Honorable Mayor Jerry Sanders
Honorable Members of the City Council
Jay M. Goldstone, Chief Operating Officer
Gail Granewich, City Treasurer
Ken Whitfield, City Comptroller
Eduardo Luna, City Auditor
Andrea Tevlin, Independent Budget Analyst