OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Subject: Internal Audit Division

OVERVIEW

The mission statement of the Auditor and Comptroller's Audit Division designates this body with the charge "to improve the efficiency, effectiveness, and accountability of City Government and provide independent, accurate, and timely information to management through the performance of operational and revenue generating audits." In formal practice this mission has placed the responsibility for the establishment and enactment of internal controls, through financial and performance audits, on the Audit Division.

In the City Auditor and Comptroller's "Second Annual Report on Internal Controls," presented to the City Council in January 2007, the Auditor stated that this required annual report on internal controls would be "limited to addressing those controls that impact the accuracy and timeliness of the City's financial reporting (i.e. financial controls)." This statement was made to clarify that the Auditor would not be addressing all internal controls and would be, in fact, excluding administrative controls. (Internal controls encompass both financial and administrative controls and are directly related to financial and performance auditing, respectively.) At the February 21, 2007 Budget and Finance Committee meeting, the CFO noted that all Audit Division staff had been reallocated to the Accounting Division over a year ago to assist with the work on the 2003 financial audits.

The following will provide information on the key aspects of a typical Audit Division by defining and exemplifying the purpose of financial and performance audits. This report will additionally elaborate on a comparative survey of twelve internal Audit Divisions in cities of comparable size throughout the U.S. (Attachment I). In particular, the survey compares the number of positions within the internal Audit Division and the time allocated within each respective department to financial versus performance auditing.

FINANCIAL AND PERFORMANCE AUDITS

The work performed by San Diego's Audit Division has historically fallen into two categories: "operational audits" and "revenue audits." These broad designations are briefly defined on the Audit Division's website.[1] Operational audits are performance audits that "provide insight into City departments and their programs." These audits are necessary to ensure that departments and programs are performing efficiently and effectively in accordance with applicable laws and regulations. Revenue audits, on the other hand, are financial audits that ensure taxes are collected and remitted properly from sources such as the hotel/motel industry (TOT), City lessees (rent), as well as, utility, cable and waste haulers (franchise fees). The Audit Division's website indicates an annual average of 150 revenue audits, resulting in approximately $1.5 million in audit recoveries. Thus, the Audit Division of the Auditor and Comptroller's Office is integral to both the collection of significant revenue and to the effective operation of internal controls within City departments.

In general, internal audits can be described as either financial audits or performance audits. The General Accounting Office (GAO) states that "financial audits provide an independent assessment of and reasonable assurance about whether an entity's reported financial condition, results, and use of resources are presented fairly in accordance with recognized criteria." Such audits include the activities related to the auditing of financial statements, but may also include issuing letters for underwriters, reporting on controls over transactions processed by service organizations, and the review of interim financial information. As discussed earlier, revenue audits conducted by the Audit Division would fall under the umbrella of financial audits. Financial audits can make up a significant portion of an auditing department's time. The results from the IBA's survey of twelve Audit Divisions in comparable cities found that these departments spent, on average, approximately 31% of their time on financial audits.

The GAO defines performance audits as "engagements that provide assurance or conclusions based on an evaluation of sufficient, appropriate evidence against stated criteria, such as specific requirements, measures, or defined business practices. Performance audits provide objective analysis so that management and those charged with governance and oversight can use the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability." Performance audits can include "compliance audits," to determine if an entity is complying with the law and/or adhering to a contract, along with "IT audits," to review and ensure adequate controls for computer systems. The operational audits conducted by the City's Audit Division in the past would fall within the category of performance audits. In the IBA survey of twelve audit departments, eleven departments spent over 50% of their time on performance audits. In fact, departments spent, on average, approximately 68% of their time on performance auditing.

[1] http://www.sandiego.gov/auditor/about/audit.shtml

STAFFING OF SAN DIEGO AUDIT DIVISION

In previous fiscal years approximately 22 positions have been budgeted to cover the responsibilities of the Audit Division. In FY 2006, 18.2 positions were budgeted under the Audit Division with an associated cost of $2.05 million. This reflected a decrease from the previous two years, when the Audit Division was staffed with 22.2 positions. In the FY 2007 budget, the Audit Division was funded for 12 positions.

According to the results from the IBA survey, 22.5 is the average number of positions within the twelve Audit Divisions among comparable cities. These results indicate that budgeted staffing within San Diego's Audit Division has been close to this average in the past, as staffing was held constant at 22.2 positions in FY 2004 and FY 2005, dropping in FY 2006 to 18.2. The decline of staffing to 12 positions in FY 2007 and their reallocation to other duties is an issue of concern.

CONCLUSION

The results of the IBA's survey of twelve Audit Divisions in comparable cities indicates that the functions of performing financial and performance audits are of primary importance in the cities surveyed. Although financial audits consumed a notable amount of time (approx. 31%) within internal Audit Divisions, more time was dedicated to performance auditing (approx. 68%). In addition, the IBA has found that staffing levels of auditing functions in twelve peer cities averaged 22.5 positions. The IBA recommends that the City Council utilize this information when considering future decisions pertaining to the internal auditing function of the City of San Diego.

While it is paramount that the City dedicates resources to issuing its financial statements, the City should focus on reestablishing an internal audit function as well. Recruitment for a new City Auditor should begin as soon as practicable to help accomplish this. The new Auditor will be vital to identifying appropriate staffing levels and moving forward with the implementation of the internal audit function.

[SIGNED]

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Attachment 1

Audit Divisions: Size and Time Allocation in Comparable Cities					
City	**Population**	**Number of City Employees**	**Size of Audit Division**	**Financial Audits: % of time[2]**	**Performance Audits: % of time[3]**
Los Angeles	3,844,829	35,895	26 actual/(35 budgeted)	45%	55%
Houston	2,016,582	21,226	10	5%	95%
Philadelphia	1,517,600	26,580	72 actual/(80 budgeted)	80-90%	10-20%
Phoenix	1,475,834	16,318	27	42%	58%
San Antonio	1,256,509	13,321	18 actual/(25 budgeted)	20%	80%
San Diego	1,255,504	11,416	N/A	N/A	N/A
Dallas	1,208,318	13,385	25	30%	70%
San Jose	912,332	6,843	19	5%	95%
Indianapolis	784,118	3,800	11	10-15%	85-90%
San Francisco	739,426	28,732	45 actual/(60 budgeted)	50%	50% - increasing this
Seattle	573,911	3,220	8	39%	61%
Denver	557,917	12,485	22	40%	60%
Portland	533,427	7,659	10	0-10%	90-100%

[2] Financial audits refer typically to audits of the City's financial reports.
[3] Performance audits can include compliance, IT, procurement, contract, and operational audits.