

Audit Manual

Conducting Performance Audits In Accordance with the Yellow Book

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CITY AUDITOR
CITY OF SAN DIEGO

Section 1

Introduction and Overview

Purpose

The purpose of this audit manual is to guide Office of the City Auditor staff in conducting or overseeing financial and performance audits as required by the City Charter, Ordinance, or derived from the Citywide risk assessment. This manual describes the audit function, and documents how the Office of the City Auditor meets and complies with generally accepted government auditing standards (GAGAS) as set forth in the Government Auditing Standards, July 2018 Revision, commonly referred to as the Yellow Book, issued by the U.S. Government Accountability Office. The Audit Manual references GAGAS, and helps Office of the City Auditor staff plan, organize, and conduct performance audits, and informs staff how to develop and report audit findings in accordance with Government Auditing Standards.

The San Diego Office of the City Auditor Manual is comprised of the following sections:

Section 1	Introduction and Overview
Section 2	Adherence to Government Auditing Standards
Section 3	Field Work Standards for Performance Audits
Section 4	Audit Process—Planning to Fieldwork
Section 5	Elements Critical To Successful Fieldwork
Section 6	Reporting Audit Results
Section 7	Audit Workplan, Recommendations, and Communications
Section 8	Fraud Hotline
Section 9	Application Guidance on Internal Control, Abuse, Fraud and Assessing the Significance of Laws, Regulations, or Provisions of Contracts or Grant Agreements
Section 10	Application Guidance for Agreed-Upon Procedures Attestation Engagements
Section 11	Guidelines for Recording and Reviewing Working Papers in MKInsight

On a periodic basis, Audit management will review and update the audit manual as necessary to ensure compliance with Government Auditing Standards.

Section 1 describes the Office of the City Auditor's mission and authority and describes the various types of audits that the City Auditor may conduct. This manual will be updated as needed to keep the office current with progress in the field of auditing or changes to auditing standards.

Mission

The Office of the City Auditor is an independent office that reports to and is accountable to the Audit Committee and City Council. The City Auditor conducts primarily performance audits of City departments, offices, and agencies in accordance with government auditing standards.

The audits may assess internal controls over financial reporting and evaluate how well the City complies with all applicable laws, rules and regulations; achieves stated goals and objectives; reports financial and performance information (reliability); efficiently and effectively uses resources; and safeguards and protects assets.

The Department's mission is:

To advance open and accountable government through accurate, independent, and objective audits and investigations that seek to improve the efficiency, effectiveness, and equity of City government.

The City Auditor will conduct all audit work in accordance with GAGAS and provide decision makers with audits that are timely, accurate, and objective.

Types of Audits and Attestation Engagements

Government Auditing Standards establishes and defines the types of engagements that audit organizations may perform. These engagements include performance and financial audits, and attestation engagements. The standards also define nonaudit services.

Performance Audits

Performance audits are defined 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.¹

¹ Reporting information without following GAGAS is not a performance audit but a nonaudit service provided by an audit organization.

Performance audits that comply with GAGAS provide reasonable assurance that the auditors have obtained sufficient, appropriate evidence to support the conclusions reached. Thus, the sufficiency and appropriateness of evidence needed and tests of evidence will vary based on the audit objectives and conclusions.

A performance audit is a dynamic process that includes consideration of the applicable standards throughout the course of the audit. An ongoing assessment of the objectives, audit risk, audit procedures, and evidence during the course of the audit facilitates the auditors' determination of what to report and the proper context for the audit conclusions, including discussion about the sufficiency and appropriateness of evidence being used as a basis for the audit conclusions. Performance audit conclusions logically flow from all of these elements and provide an assessment of the audit findings and their implications.

Performance Audit Objectives May Vary

Audit standards have established that performance audit objectives may vary widely and include assessments of program effectiveness, economy, and efficiency; internal control; compliance; and prospective analyses. These overall objectives are not mutually exclusive. Thus, a performance audit may have more than one overall objective. For example, a performance audit with an initial objective of program effectiveness may also involve an underlying objective of evaluating internal controls to determine the reasons for a program's lack of effectiveness or how effectiveness can be improved.

Program effectiveness and results, along with audit objectives are frequently interrelated with economy and efficiency objectives. Audit objectives that focus on program effectiveness and results typically measure the extent to which a program is achieving its goals and objectives. Audit objectives that focus on economy and efficiency address the costs and resources used to achieve program results. Examples of audit objectives in these categories include:

- a. assessing the extent to which legislative, regulatory, or organizational goals and objectives are being achieved;
- b. assessing the relative ability of alternative approaches to yield better program performance or eliminate factors that inhibit program effectiveness;
- c. analyzing the relative cost-effectiveness of a program or activity;
- d. determining whether a program produced intended results or produced results that were not consistent with the program's objectives;
- e. determining the current status or condition of program operations or progress in implementing legislative requirements;
- f. determining whether a program provides equitable access to or distribution of public resources within the context of statutory parameters;

- g.** assessing the extent to which programs duplicate, overlap, or conflict with other related programs;
- h.** evaluating whether the audited entity is following sound procurement practices;
- i.** assessing the reliability, validity, or relevance of performance measures concerning program effectiveness and results, or economy and efficiency;
- j.** assessing the reliability, validity, or relevance of financial information related to the performance of a program;
- k.** determining whether government resources (inputs) are obtained at reasonable costs while meeting timeliness and quality considerations;
- l.** determining whether appropriate value was obtained based on the cost or amount paid or based on the amount of revenue received;
- m.** determining whether government services and benefits are accessible to those individuals who have a right to access those services and benefits;
- n.** determining whether fees assessed cover costs;
- o.** determining whether and how the program's unit costs can be decreased or its productivity increased; and
- p.** assessing the reliability, validity, or relevance of budget proposals or budget requests to assist legislatures in the budget process.

Performance Audits Can Include Internal Control Objectives

Internal control audit objectives relate to an assessment of the component of an organization's system of internal control that is designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations. Internal control objectives also may be relevant when determining the cause of unsatisfactory program performance. Internal control comprises the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal control includes the processes and procedures for planning, organizing, directing, and controlling program operations, and management's system for measuring, reporting, and monitoring program performance. Examples of audit objectives related to internal control include an assessment of the extent to which internal control provides reasonable assurance about whether:

- a.** organizational missions, goals, and objectives are achieved effectively and efficiently;
- b.** resources are used in compliance with laws, regulations, or other requirements;
- c.** resources, including sensitive information accessed or stored outside the organization's physical perimeter, are safeguarded against unauthorized acquisition, use, or disposition;

- d. management information, such as performance measures, and public reports are complete, accurate, and consistent to support performance and decision making;
- e. the integrity of information from computerized systems is achieved; and
- f. contingency planning for information systems provides essential back-up to prevent unwarranted disruption of the activities and functions that the systems support.

Compliance audit objectives relate to compliance criteria established by laws, regulations, contract provisions, grant agreements, and other requirements that could affect the acquisition, protection, use, and disposition of the entity's resources and the quantity, quality, timeliness, and cost of services the entity produces and delivers. Compliance objectives include determining whether

- a. the purpose of the program, the manner in which it is to be conducted, the services delivered, the outcomes, or the population it serves is in compliance with laws, regulations, contract provisions, grant agreements, and other requirements;
- b. government services and benefits are distributed or delivered to citizens based on the individual's eligibility to obtain those services and benefits;
- c. incurred or proposed costs are in compliance with applicable laws, regulations, and contracts or grant agreements; and
- d. revenues received are in compliance with applicable laws, regulations, and contract or grant agreements.

Prospective analysis audit objectives provide analysis or conclusions, about information that is based on assumptions about events that may occur in the future along with possible actions that the audited entity may take in response to the future events. Examples of objectives pertaining to this work include providing conclusions based on:

- a. current and projected trends and future potential impact on government programs and services;
- b. program or policy alternatives, including forecasting program outcomes under various assumptions;
- c. policy or legislative proposals, including advantages, disadvantages, and analysis of stakeholder views;
- d. prospective information prepared by management;
- e. budgets and forecasts that are based on (1) assumptions about expected future events and (2) management's expected reaction to those future events; and
- f. management's assumptions on which prospective information is based.

Financial audits

The Yellow Book defines financial audits as:

An audit primarily concerned with providing reasonable assurance about whether financial statements are presented fairly in all material respects in conformity with generally accepted accounting principles (GAAP), or with a comprehensive basis of accounting other than GAAP. Other objectives of financial audits, which provide for different levels of assurance and entail various scopes of work, may include:

- providing special reports for specified elements, accounts, or items of a financial statement;
- reviewing interim financial information;
- issuing letters for underwriters and certain other requesting parties;
- reporting on the processing of transactions by service organizations; and
- auditing compliance with regulations, relating to federal award expenditures and other governmental financial assistance, in conjunction with or as a by-product of a financial statement audit.

Attestation engagements

The Yellow Book defines an attestation engagement as:

An engagement concerned with examining, reviewing, or performing agreed-upon procedures on a subject matter or an assertion about a subject matter and reporting on the results. The subject matter of an attestation engagement may take many forms, including historical or prospective performance or condition, physical characteristics, historical events, analyses, systems and processes, or behavior. Attestation engagements can cover a broad range of financial or non-financial subjects and can be part of a financial audit or performance audit. Possible subjects of attestation engagements could include reporting on:

- an entity's internal control over financial reporting;
- an entity's compliance with requirements of specified laws, regulations, rules, contracts, or grants;
- the effectiveness of an entity's internal control over compliance with specified requirements, such as those governing the bidding for, accounting for, and reporting on grants and contracts;
- management's discussion and analysis presentation;
- prospective financial statements or pro-forma financial information;
- the reliability of performance measures;
- final contract cost;
- allowability and reasonability of proposed contract amounts; and
- specific procedures performed on a subject matter (agreed-upon procedures).

Nonaudit Services

The Yellow Book establishes that audit organizations that provide nonaudit services (professional services) must communicate to management that the scope of work performed does not constitute an audit under the yellow book. Further, audit organizations that provide nonaudit services must evaluate whether providing nonaudit services creates an independence impairment in fact or appearance with respect to the entities they audit. Nonaudit services are covered in Section 2 of the Audit Manual.

Office of the City Auditor Policy

Unless noted, the type of audit work Office of the City Auditor performs will be considered performance audits. As a result, Office of the City Auditor will conduct all of its audits under the performance audit standards. We should note that Office of the City Auditor does not perform the City's financial audits because the City hires an external auditor to conduct the financial statement audits.

Auditor Review of Audit Handbook

Auditors have a responsibility to remain aware and up to date regarding office policies and procedures. Each auditor is given a copy of the Audit Manual (or provided access to an electronic version) for their review. Each auditor is responsible for reading and understanding the requirements promulgated in the Audit Handbook. Where auditors have questions related to policies and procedures, the auditor shall approach an audit manager to obtain clarification. From time to time, the office may issue directives to address pressing issues. Directives may be integrated into the Audit Handbook when the office conducts its periodic annual review of the quality control system.

Office of the City Auditor Policy

Each auditor shall complete a written form indicated that they have received a copy (of access), read, and understand the office Audit Handbook.

Ethical Principles in Government Auditing

The July 2018 Revision to Government Auditing Standards emphasizes ethical principles as the foundation, discipline, and structure behind the implementation of the standards, including establishing five key ethical principles that guide the work of those conducting audits in accordance with the standards. Section II of the Audit Manual identifies the five key ethical principles and establishes the policy of requiring all auditors in the Office of the City Auditor to adhere to those principles.

Government Auditing Standards Section 3.03 establishes the following:

Because auditing is essential to government accountability to the public, the public expects audit organizations and auditors who conduct their work in accordance with generally accepted government auditing standards (GAGAS) to follow ethical principles. Management of the audit organization sets the tone for ethical behavior throughout the organization by maintaining an ethical culture, clearly communicating acceptable behavior and expectations to each employee, and creating an environment that reinforces and encourages ethical behavior throughout all levels of the organization. The ethical tone maintained and demonstrated by management and staff is an essential element of a positive ethical environment for the audit organization.

Ethical Principles

The following ethical principles provide a framework for applying GAGAS. Each principle is described, so that auditors can consider the facts and circumstances of each situation within the framework of these ethical principles.

Ethical Principle	Description
Public Interest	<p>The public interest is defined as the collective wellbeing of the community of people and entities the auditors serve. Observing integrity, objectivity, and independence in discharging their professional responsibilities assists auditors in meeting the principle of serving the public interest and honoring the public trust. These principles are fundamental to the responsibilities of auditors and critical in the government environment.</p> <p>A distinguishing mark of an auditor is acceptance of responsibility to serve the public interest. This responsibility is critical when auditing in the government environment. GAGAS embody the concept of accountability for public resources, which is fundamental to serving the public interest.</p>

<p>Integrity</p>	<p>Public confidence in government is maintained and strengthened by auditors' performing their professional responsibilities with integrity. Integrity includes auditors' conducting their work with an attitude that is objective, fact-based, nonpartisan, and non-ideological with regard to audited entities and users of the auditors' reports. Within the constraints of applicable confidentiality laws, rules, or policies, communications with the audited entity, those charged with governance, and the individuals contracting for or requesting the audit are expected to be honest, candid, and constructive.</p> <p>Making decisions consistent with the interest of the program or activity under important part of the principle of integrity. In discharging their professional responsibilities, encounter conflicting pressures from audited entity, various levels of government, likely users. Auditors may also encounter pressures to violate ethical principles to achieve personal or organizational gain. In resolving those conflicts and pressures, acting with integrity means that auditors place priority on their responsibilities to the public interest.</p>
<p>Objectivity</p>	<p>The credibility of auditing in the government sector is based on auditors' objectivity in discharging their professional responsibilities. Objectivity includes being independent in fact and appearance when providing audit and attestation engagements, maintaining an attitude of impartiality, having intellectual honesty, and being free of conflicts of interest. Avoiding conflicts that may, in fact or appearance, impair auditors' objectivity in performing the audit or attestation engagement is essential to retaining credibility. Maintaining objectivity includes a continuing assessment of relationships with audited entities and other stakeholders in the context of the auditors' responsibility to the public. The concepts of objectivity and independence are closely related. Independence impairments impact objectivity.</p>

Ethical Principle	Description
<p>Proper Use of Government Information, Resources, and Position</p>	<p>Government information, resources, to be used for official purposes and not inappropriately for the auditor's personal manner contrary to law or detrimental to interests of the audited entity or the audit concept includes the proper handling classified information or resources.</p> <p>In the government environment, the public's right to the transparency of government information has to be balanced with the proper use of that information. In addition, many government programs are subject to laws and regulations dealing with the disclosure of information. To accomplish this balance, exercising discretion in the use of information acquired in the course of auditors' duties is an important part in achieving this goal. Improperly disclosing any such information to third parties is not an acceptable practice.</p> <p>Accountability to the public for the proper use and prudent management of government resources is an essential part of auditors' responsibilities. Protecting and conserving government resources and using them appropriately for authorized activities is an important element in the public's expectations for auditors.</p> <p>Misusing the position of an auditor for personal gain violates an auditor's fundamental responsibilities. An auditor's credibility can be damaged by actions that could be perceived by an objective third party with knowledge of the relevant information as improperly benefiting an auditor's personal financial interests or those of an immediate or close family member; a general partner; an organization for which officer, director, trustee, or employee; or an organization with which the auditor is negotiating concerning future employment.</p>

Ethical Principle	Description
Professional Behavior	<p>High expectations for the auditing profession include compliance with laws and regulations and avoidance of any conduct that might bring discredit to auditors' work, including actions that would cause an objective third party with knowledge of the relevant information to conclude that the auditors' work was professionally deficient.</p> <p>Professional behavior includes auditors' putting forth an honest effort in performance their duties and professional services in accordance the relevant technical and professional standards.</p>

Office of the City Auditor Policy

The City Auditor and all audit staff are required to adhere to and follow the five key ethical principles. On an annual basis, the City Auditor and all audit staff will review the five ethical principles and attest in writing that they will adhere to and follow the identified principles. In the event, the City Auditor or audit staff cannot comply with or adhere to the identified principles, they should immediately notify their appointing authority of the circumstances involving the ethical principles. See Annual Ethical Principle Statement below. Also, see below the Office of the City Auditor's Policy on Gifts and Form 700 Reporting, which all audit staff are required to follow to ensure they avoid circumstances that create a threat of bias that could impair independence.

Annual Ethical Principle Statement

Office of the City Auditor

City of San Diego

The July 2018 Revision to Government Auditing Standards emphasizes ethical principles as the foundation, discipline, and structure behind the implementation of the standards, including establishing five key ethical principles that guide the work of those who conduct audits in accordance with the standards. The ethical principles involve 1) public interest, 2) integrity, 3) objectivity, 4) proper use of government information, resources, and position, and 5) professional behavior. The City Auditor and all audit staff are required to adhere to and follow the five key ethical principles listed below. On an annual basis, the City Auditor and all audit staff will review the five ethical principles and attest that they will adhere to and follow the identified principles.

Public Interest

The public interest is defined as the collective well being of the community of people and entities the auditors serve. Observing integrity, objectivity, and independence in discharging their professional responsibilities assists auditors in meeting the principle of serving the public interest and honoring the public trust. These principles are fundamental to the responsibilities of auditors and critical in the government environment.

A distinguishing mark of an auditor is acceptance of responsibility to serve the public interest. This responsibility is critical when auditing in the government environment. GAGAS embody the concept of accountability for public resources, which is fundamental to serving the public interest.

Integrity

Public confidence in government is maintained and strengthened by auditors performing their professional responsibilities with integrity. Integrity includes auditors performing their work with an attitude that is objective, fact-based, nonpartisan, and non-ideological with regard to audited entities and users of audit reports. Within the constraints of applicable confidentiality laws, regulations, or policies, communications with the audited entity, those charged with governance, and the individuals contracting for or requesting the engagement are expected to be honest, candid, and constructive.

Making decisions consistent with the interest of the program or activity under important part of the principle of integrity, discharging their professional responsibilities, encounter conflicting pressures from audited entity, various levels of government, likely users. Auditors may also encounter pressures to violate ethical principles to achieve personal or organizational gain. In resolving those conflicts and pressures, acting with integrity means that auditors place priority on their responsibilities to the public interest.

Objectivity

The credibility of auditing in the government sector is based on auditors' objectivity in discharging their professional responsibilities. Objectivity includes being independent in fact and appearance when conducting an audit and attestation engagements, maintaining an attitude of impartiality, having intellectual honesty, and being free of conflicts of interest. Avoiding conflicts that may, in fact or appearance, impair auditors' objectivity in performing the audit or attestation engagement is essential to retaining credibility.

Maintaining objectivity includes a continuing assessment of relationships with audited entities and other stakeholders in the context of the auditors' responsibility to the public. The concepts of objectivity and independence are closely related. Independence impairments impact objectivity.

Proper Use of Government Information, Resources, and Position

Government information, resources, to be used for official purposes and not inappropriately for the auditor's personal manner contrary to law or detrimental to interests of the audited entity or the audit concept includes the proper handling of classified information or resources.

In the government environment, the public's right to the transparency of government information has to be balanced with the proper use of that information. In addition, many government programs are subject to laws and regulations dealing with the disclosure of information. To accomplish this balance, exercising discretion in the use of information acquired in the course of auditors' duties is an important part in achieving this goal. Improperly disclosing any such information to third parties is not an acceptable practice.

As accountable professionals, accountability to the public for the proper use and prudent management of government resources is an essential part of auditors' responsibilities. Protecting and conserving government resources and using them appropriately for authorized activities are important elements of the public's expectations for auditors.

Misusing the position of an auditor for financial gain or other benefits violates an auditor's fundamental responsibilities. An auditor's credibility can be damaged by actions that could be perceived by an objective third party with knowledge of the relevant information as improperly benefiting an auditor's personal financial interests or those of an immediate or close family member; a general partner; an organization for which the auditor serves as an officer, director, trustee, or employee; or an organization with which the auditor is negotiating concerning future employment.

Professional Behavior

High expectations for the auditing profession include compliance with laws and regulations and avoidance of any conduct that might bring discredit to auditors' work, including actions that would cause an objective third party with knowledge of the relevant information to conclude that the auditors' work was professionally deficient. Professional behavior includes auditors putting forth an honest effort in performance of their duties and professional services in accordance with the relevant technical and

I _____, auditor for the City of San Diego, have reviewed the stated ethical principles and pledge to adhere to the principles to the best of my ability. In the event, I cannot comply with or adhere to the identified principles I will immediately notify my appointing authority of the circumstances involving the ethical principles.

Auditor's Signature: _____

Date: _____

City Auditor's Signature: _____

Date: _____

Policy on Gifts and Form 700 Reporting
Office of the City Auditor's
City of San Diego

Government Auditing Standards provides examples of circumstances that create a threat of bias for an auditor that could impair independence. One example is an auditor accepting gifts or preferential treatment from an audited entity, unless the value is trivial or inconsequential.² Therefore, City Auditor staff may not accept any gifts or preferential treatment from an auditee unless the value is trivial or inconsequential.

Examples of gifts with a trivial or inconsequential value are accepting a bottle of water, a cup of coffee made at the office, or a can of soda while working with an auditee. Examples of gifts exceeding a trivial or inconsequential value are allowing an auditee to purchase your lunch, or purchase a coffee for you at a coffee shop. If you are uncertain if a gift offered to you is trivial or inconsequential in value, you should not accept it. While each employee is the first to decide whether to accept any gift or favor, he/she must recognize that *others* will decide if there is an appearance of influencing an employee's, or the City's, actions. If you are uncertain, you can seek advice from the City Auditor prior to accepting a gift.

The [City of San Diego Employee Code of Conduct Handbook](#) also has restrictions on accepting gifts that must be followed by City Auditor staff:

"I.I Gifts/Favors

Employees shall not accept money or other consideration or favors from anyone other than the City for the performance of an act which they would be required or expected to perform in the regular course of their duties.

An employee is prohibited from accepting any gift from persons doing business with, or seeking to do business with, the City when accepting the gift might reasonably be interpreted as an attempt to influence his/her actions with respect to City business. [[Council Policy 000-04; A.R. 95.60, sec. 3.4](#)]

Comment: Compensation for performing public duties is limited to an employee's salary, benefits and any personal satisfaction he/she may receive in the performance of his/her job. While each employee is the first to decide whether to accept any gift or favor, he/she must recognize that *others* will decide if there is an appearance of influencing an employee's, or the City's, actions.

Gifts may include anything of economic value, whether in the form of money, service, loan, travel, entertainment, hospitality, item or promise. Employees are permitted to accept plaques, souvenirs or mementos of nominal value associated with a given event."

In addition, City Auditor staff must be familiar with and follow the restrictions and reporting requirements for gifts established by the State of California Fair Political Practices Commission (FPPC). The FPPC's guide

² Government Auditing Standards, 3.41(d).

regarding Limitations and Restrictions on Gifts, Honoraria, Travel and Loans guide can be found at <http://www.fppc.ca.gov/content/dam/fppc/NS-Documents/TAD/Public%20Officials%20and%20Employees/StateGiftFactSheet.pdf>.

The rules and requirements for the FPPC Form 700 – Statement of Economic Interest must be reviewed and filed by all City Auditor staff when they initially accept a position with the Office of the City Auditor and then annually each calendar year thereafter. The Form 700 can also be found at: <http://www.fppc.ca.gov/Form700.html>.

Each City Auditor staff member should file the Form 700 through the City Clerk's electronic filing system, and instructions can be found at: <http://citynet.sannet.gov/cityclerk/pdf/howsei.pdf>.