

# 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, December 2011 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	Ethical Principles in Government
Section 3	Audit Standards—General Standards
Section 4	Field Work Standards for Performance Audits
Section 5	Audit Process—Planning to Fieldwork
Section 6	Elements Critical To Successful Fieldwork
Section 7	Reporting Audit Results
Section 8	Audit Workplan, Recommendations, and Communications
Section 9	Fraud Hotline
Section 10	Supplemental Guidance on Internal Control, Abuse, Fraud and Assessing Significance of Laws, Regulations, or Provisions of Contracts or Grant Agreements
Section 11	Supplemental Guidance for Agreed-Upon Procedures Attestation Engagements
Section 12	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 that seek to improve the economy, efficiency, and effectiveness 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.<sup>1</sup>

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.

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

**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 3 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.