

Section 8

Risk Assessment, Audit Work Plan, Recommendation Follow-Up, and Monthly and Annual Reports

In this section of the audit manual, we discuss the process for developing a citywide risk assessment model, an annual audit work plan, recommendation following-up, and communicating audit achievements through accomplishments and activities reports.

Citywide Risk Assessment Model

On an annual basis, the Office of the City Auditor will conduct a Citywide Risk Assessment to identify potential audit subjects. Generally Accepted Government Auditing Standards (GAGAS) and the Institute of City Auditors' Standards (IIAS) require the chief audit executive to establish a risk-based approach to determine the priorities for internal audit activities. The Office of the City Auditor will complete a Citywide Risk Assessment as a means to help identify, measure, and prioritize the City's potential audits based on the level of risk to the City. The results of the completed Citywide Risk Assessment will be utilized in preparing City Auditor's Audit's annual work plan. When a City Activity Group is selected to be audited, we will perform a more in depth risk assessment to ensure our audit procedures cover the areas of highest risk for that Activity Group.

The objective of this risk assessment process is to identify, measure, and prioritize the City's potential audits (auditable units) based on the level of risk to City operations.

There are four main steps that will be followed to prepare the annual Citywide Risk Assessment Model:

1. Review professional standards.
 - a. Review the current GAGAS and IIAS recommended procedures for risk assessments.
 - b. Review risk assessment models currently used by other similar government entities.
2. Define the City's audit universe.
 - a. The audit universe is a listing of all of the City's significant "Auditable Units" (all of the potential audits that could be performed).
 - b. Create a list of all City Departments and significant City Agencies and their primary functions (Activity Groups) as the Auditable Units.
 - c. Use City budget and/or other data available, the City's CAFR, prior audits, and input from those in charge of operations to create the audit universe.
3. Identify and rank major risks related to the City's Auditable Units.

- a. Those in charge of City operations will complete questionnaires designed to identify and rank the major risks associated with the City's primary activities (Auditable Units).
 - b. The questionnaires will be designed to measure quantifiable risk factors to score the level of risk for the City's Auditable Units. Examples of measurable risk factors are:
 - Budgeted expenditures.
 - Budgeted revenue.
 - Number of budgeted employees.
 - Annual value of citywide transactions responsible for in addition to budgeted expenditures and revenue (e.g. Payroll Section reviews citywide payroll payments of approx \$650 million annually).
 - Liquidity and negotiability of assets (Level of cash and assets easily converted to cash handled by the department).
 - Compliance with regulations (Level of potential loss due to regulatory sanctions or penalties).
 - Public exposure and interest.
 - Complexity of transactions.
 - Quality of internal controls.
 - c. The questionnaires completed by management will assign a risk score of 0 (low), 3 (medium low), 5 (medium), 7 (medium high), or 9 (high) for each of the measurable risk factors used based on the answers provided.
4. Complete the Citywide Risk Assessment by calculating the total risk score for each Auditable Unit and sort them in order of highest risk score to the lowest.
 - a. Tabulate the risk scores gathered from the questionnaires
 - b. Determine the weights that will be assigned to each risk factor based on relative importance.
 - c. Calculate the total risk score for each auditable unit by applying the weights to the risk scores and compute the total.
 - d. Determine the risk ranking for each auditable unit by stratifying the total risk scores in descending order by tenths, and identifying the top 30 percent (or those ranking 10, 9, or 8) as High Risk, the next 40 percent (ranking 7, 6, 5, 4) as Medium Risk, and the bottom 30 percent (score of 3, 2 or 1) as Low Risk.

The Auditable Units (City Departments / Agencies and their primary functions) with a high risk score merely indicates that the services they provide or the functions they are responsible for are by nature a high risk activity because of such factors as having a large amount of

expenditures and revenues or a high level of liquid assets such as cash. A high risk score indicates that if something were to go wrong within that Activity Group, it could have a greater impact to the City than a lower risk Activity Group. A high risk score does not mean that an activity is being managed ineffectively or indicate whether adequate internal controls are in place and functioning as intended. The overall results identify the activities with the highest risk factors that may warrant and benefit from additional management action or audit services. A risk assessment of the City's information technology systems will also be prepared. The completed Risk Assessment Model and IT Risk Assessment will form the basis for the City Auditor's Audit Work Plan. Annually, the Audit Committee will place on the meeting agenda the risk assessment reports along with the proposed audit work plan.

Audit Work Plan

At the beginning of each fiscal year, the City Auditor will propose an annual audit work plan that will identify all proposed audits to be undertaken throughout the year. The work plan will identify 1) all audits in progress; 2) audits not started; 3) required annual audits, such as the Mission Bay Funds and Inventory Audits; 4) on-going audit assignments, such as Recommendation Follow-up and Fraud Hotline activities; 5) newly proposed audits based on the Citywide Risk Assessment model; and 6) input from the Mayor, City Council, and Administration on potential audit subjects. Additional information will include a preliminary audit objective and estimated audit hours. Audit requests received during the fiscal year will be addressed through the Audit Committee.

The Annual Audit Work Plan will be presented to the Audit Committee on an annual basis by the second meeting of the fiscal year together with the results of the risk assessment. Requests to add audits to the work plan midyear will be presented to the Audit Committee with a City Auditor analysis of the impact of adding the proposed audit to the work plan.

Recommendation Follow-Up Process

In order to ensure recommendations are implemented on a timely basis, the City Auditor will undertake an semi-annual recommendation follow-up process to track the status of all previous audit recommendations. Beginning in February 2009, the City Auditor began preparing a semi-annual report on the status of all open recommendations for the previous six months ending December 31, 2008.

In January and July of each year, the Office communicates with the Administration to initiate the recommendation follow up process. The open recommendations are accessed by the administration via the web portal. During this process all open recommendation statuses are updated by the departments. For recommendations that are reported as implemented, the management official should submit proof of implementation. All management responses should be approved by the Department Director and the Chief Operating Officer, or his designee. Audit staff will review management responses and conduct follow-up work to verify recommendations deemed "Implemented". For each open recommendation, audit staff will write a brief summary of their findings, and note if the recommendation is implemented, in

process, or not implemented. The report will also call out recommendations that need additional funding for implementation; result in increased revenues; or achieve cost savings for the City. The Administration will have an opportunity to review the draft recommendation report prior to issuance.

Semi-annually, the Audit Committee will place on the meeting agenda the Recommendation Follow-up Report. The City Auditor will make a presentation on the status of all previously issued recommendations, with estimated timeframes for implementation.

Monthly Reports To Audit Committee

Approximately each month, the City Auditor will issue a report to the Audit Committee. The report will include 1) a listing of issued audit reports and memorandums; 2) a listing of all ongoing audit assignments, including information on audit status, hours, and target issuance date; 3) approved audits not started; and 4) a listing of significant City Auditor and staff activities and accomplishments.

At each Audit Committee meeting, the meeting agenda will generally include an update from the City Auditor regarding office activities and accomplishments. The City Auditor will present a summary of the audit activities since the prior audit committee meeting.

Accomplishments Reports

Public accountability is an important component of trust. It is essential for the Office of the City Auditor to make public a record of its activities and accomplishments on a periodic basis. The City Auditor will periodically issue a report with the following information:

- Mission statement.
- Information on types of audits performed.
- Benefits to the City.
- Summary of audit work performed - executive summary of audit reports.
- Details regarding the audit reports issued and number of recommendations made to improve City operations during the reporting period.
- Any noteworthy recognition of leadership, professional development and other accomplishments.

The City Auditor will distribute this report to the Mayor, City Council, and the Audit Committee members. If desired, this report will be scheduled for an Audit Committee meeting.