



THE CITY OF SAN DIEGO

DATE: April 2, 2013

TO: Honorable Members of the Audit Committee

FROM: Eduardo Luna, City Auditor

SUBJECT: **UPDATED- Office of the City Auditor Fiscal Year 2014 Proposed Budget**

Under City Charter Section 39.1, the Audit Committee recommends to the City Council the annual compensation of the City Auditor and annual budget for the Office of the City Auditor (OCA). To facilitate the Audit Committee's deliberation, I am presenting the Office of the City Auditor's proposed FY 2014 budget additions, including staffing and other needs as well as performance-related information for the Audit Committee's consideration.

Fiscal Year 2014 Office of the City Auditor Budget Requirements

The City Auditor is requesting additional budget needs totaling **\$599,686** to improve the efficiency and effectiveness of the Office of the City Auditor and to maintain and retain skilled auditors to continue producing high impact audits with significant results. The following provides the details of these budget requests.



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The Mayor's FY 2013 Adopted and FY 2014 Proposed Additions for the OCA are summarized in Exhibit 1.

Exhibit 1: FY 2014 OCA Budget Request

| Budget Request Category | FY 2013 Adopted Budget | FY 2014 Proposed Additions |
|----------------------------------|---------------------------------------|---|
| Positions (FTE) | 20.0 | 3.5 |
| Salaries and Wages | \$1,758,631 | \$368,268 |
| Fringe Benefits | 809,089 | 176,073 |
| Subtotal | 2,567,720 | 544,341 |
| Non-Personnel | 297,646 | 55,345 |
| Subtotal | 2,865,366 | 599,686 |
| CAFR Audit Expense | 793,739 | |
| Internal Controls Project | 150,000 | |
| Total | \$3,809,105 | \$599,686 |

Exhibit 2 provides additional detail regarding OCA's request (see also Attachment 1).

Exhibit 2: FY 2014 OCA Budget Request Detail

| Budget Request Category (Detail) | Proposed Increase to Adopted FY 2013 Budget | Proposed Increase to FY 2013 Positions |
|---|--|---|
| 2 Performance Auditor Positions, 1 Administrative Assistant Position and 0.5 Hourly Staff | \$473,574 | 3.5 FTEs |
| Restoration of FY13 Personnel Base Budget | 70,767 | |
| IT Discretionary/Committed Contracts | 20,401 | |
| Restoration of Training Budget and Additional Training Budget for the Requested Positions | 29,944 | |
| Peer Review | 5,000 | |
| Total | \$599,686 | 3.5 FTEs |

Discussion and Analysis related to Fiscal Year 2014 OCA Requested Budget

FTE Staffing Request

OCA is requesting an additional 3.5 FTEs to bring the office to a sustainable staffing level. This request is based on 1) OCA's current staffing; 2) staffing levels recommended in an independent external study; and 3) estimated sustainable staffing levels necessary to carry out a risk-based audit work plan on defined auditable units within the City.

Current Staffing Level:

Since 2011, budgeted OCA FTE staffing levels have increased minimally—from 18.5 FTEs in 2011 to 20 FTEs in 2013. OCA is currently comprised of the City Auditor, Assistant City Auditor, 17 FTE Performance Auditors, and 1 FTE administrative staff.

Jefferson Wells Report Recommended Staffing Level:

The 2008 Jefferson Wells study, *Report to the City of San Diego Audit Committee – Best Practices, Analysis and Recommendations Risk Assessment Development, Annual Audit Work Plan Development, and Internal Audit Function Staffing*, included a recommendation that the City of San Diego should have at least 24.5 FTE audit positions to provide sufficient audit coverage for auditing high-risk areas on a three-year cycle. This recommendation included an analysis of the City's internal audit function at that time, as well as comparisons to staffing in other government entities of similar size (such as Austin, Denver, Phoenix, and Orange County). Based on the study's results, current OCA staffing remains below the recommended level identified in the report as necessary to address high-risk areas of City operations. The Audit Committee may wish to revisit the Jefferson Wells analysis and assess the appropriate equilibrium of audit resources for a municipality with a budget of \$2.6 billion.

OCA Sustainable Staffing Level Based on Audit Work Plan:

The Jefferson Wells report recommendations focused on maintaining a department with adequate staffing for sufficient scope coverage of the underlying internal audit work for the City of San Diego. At the time of the report, no City of San Diego Annual Audit Work Plan existed regarding the total number of hours needed to accomplish the City's audits. The best practice theoretical guidance, per the report, estimated the City to have a total of approximately 460 auditable units with risk weighting ranging proportionally from low to high. The risk weighting impacts the number of audit hours required and the frequency of audits. According to the report, high risk units should be audited at least every three years, medium risk units every five years and low risk units should be addressed using some judgmental assessments.

OCA developed and annually updates a Citywide Risk Assessment and Audit Work Plan as a means to help identify, measure, and prioritize the City's potential audits based on the level of risk to the City. The FY 2013 Work Plan continued seven audits from the previous year, identified eleven new performance audits, and described other significant audit activities.

In developing the annual Work Plan, OCA defined 235 auditable units within the City. OCA defines the auditable universe (that is, all of the City's auditable units) by parsing the list of City Departments, significant City Agencies, and their primary activity groups into the auditable units.

Assuming a 5-year audit cycle and based on 235 auditable units within the City, OCA calculates its proposed sustainable staffing level as shown in Exhibit 3.

Exhibit 3: OCA Sustainable FTE Staffing Level Estimate

| | |
|--|----------------|
| Number of Auditable Units | 235 units |
| Estimated Hours per Audit | 1,000 hours |
| Total Estimated Audit Hours <i>(Auditable Units x Est. Hours/Audit)</i> | 235,000 hours |
| Audit Hours per 5-year Cycle <i>(Tot. Est. Audit ÷ 5 years)</i> | 47,000 hours |
| Sustainable Staffing Level Based on 1,560 available audit hours per 1 FTE <i>(Audit Hrs per 5-year Cycle ÷ 1,560)</i> | 30 FTEs |

Based on the table above, 30 FTEs is OCA's sustainable staffing level necessary to carry out a risk-based audit work plan on defined auditable units within the City—slightly higher than the 24.5 FTE level identified in 2008 Jefferson Wells study. However, OCA plans to implement electronic audit workpapers in FY 2014. Once fully implemented, we anticipate increased efficiency of roughly 20 percent, which equates to 200 fewer hours per audit, based on a 1,000 hour audit.²

Consistent with the discussion and analysis above, OCA believes the optimal staffing level for the office is 24 FTEs. The request is based on a sustainable level of 30 FTEs level less 20 percent—or 6 FTEs—for efficiency gains through implementation of electronic workpapers.

² Studies of audit operations indicate that auditors spend approximately 40 percent of total audit hours on workpaper preparation, review, and report processing. Electronic workpaper systems have been found to significantly reduce the amount of time required for workpaper-related tasks. Surveys of audit departments have reported 20-30 percent efficiency gains associated with fully implemented workpaper systems.

Salaries and Associated Personnel Costs Related to OCA FY 2014 Budget Request

In calculating the requested budget increase for FTE increases, the OCA considered its current organizational structure, as described in Exhibit 4.

Exhibit 4: Current OCA Staffing Levels and Salary Averages

| FTE | Position | Average Salary |
|------------|----------------------------|-----------------------|
| 3 | Audit Managers | \$ 104,246 |
| 4 | Senior Performance Auditor | 92,115 |
| 2 | Performance Auditor II | 81,535 |
| 8 | Performance Auditor I | 69,540 |
| 17 | | |

In order to bring OCA to a sustainable staffing level, we are requesting 2 FTE Performance Auditors. If approved, we would likely hire at the Performance Auditor II and/or Senior Performance Auditor levels in order to adequately balance our current staffing structure (shown above).

Additionally, OCA has grown since its inception and our administrative needs have increased proportionally. We need additional support with administrative duties such as budget development and monitoring, entering Fraud Hotline reporting data, preparing memorandums, audit report formatting, and other administrative activities.

Exhibit 5 below shows estimated costs associated with our FY 2014 staffing request

Exhibit 5: Salary, Wage, and Benefit Costs Related to FY 2014 OCA Request

| FTE | Position | Salary | Fringe Benefits |
|-----|--------------------------|----------|-----------------|
| 1.0 | Performance Auditor | \$96,212 | \$63,244 |
| 1.0 | Performance Auditor | 96,212 | 63,244 |
| 1.0 | Administrative Assistant | 59,740 | 45,901 |
| 0.5 | Hourly Personnel | 45,695 | 3,684 |

Note: Fringe benefits are derived from the estimates provided to OCA by the Financial Management department. From FY 2011 to FY 2013, fringe benefits have ranged from 40-45 percent. See Attachment 1 for additional detail on the composition of fringe benefits

Restoration of FY 2013 Personnel Base Budget

We are requesting **\$70,767** in restoration of FY13 salary costs to continue to support the staffing structural realignment put into place in January and February of 2013 (see Exhibit 4 above), which more closely resembles the structure of other City offices and private industry. Leading industry practices delineate and compensate staff based on expertise, ability, and performance. For example, some offices stratify positions, such as defining an individual as Accountant I, II, III, IV. Each level expands staff responsibilities, complexity of work, and level of authority over the work performed.

Under the City Charter and Government Auditing Standards, the City Auditor is responsible for appropriately compensating his staff. To this end, the City Auditor proposed and the Audit Committee accepted the proposal to budget each staff position at an average of \$96,212. As we hired auditors at compensation levels significantly below this amount, the City swept away the difference between the actual salary and the approved average. The requested augmentation would maintain the average budgeted amount at \$77,704 (not including executives, managers and administrative staff), still below the originally approved \$96,212.

IT Discretionary/Committed Contracts

We are requesting **\$20,401** for IT Discretionary/Committed expenses. The City Auditor's Office is currently in the process of purchasing an electronic workpaper system, as approved in our FY 2013 budget. A portion of this request is for the ongoing maintenance of the electronic workpaper system once selected. Maintenance fees are

required as part of the software license. Additional funding from this request is for hardware replacement and data analytic software licenses.

Restoration of Training Budget

We are requesting **\$29,944** to reestablish the portion of our training budget that was reduced in FY2012 (\$25,000) and add the training budget for the newly requested positions above. Government Auditing Standards require each auditor to receive at least 80 hours of continuing professional education (CPE) every two years, with no less than 20 hours in any given year. While group training sessions, local association meetings and webinars have provided some low cost avenues for training, we are requesting the additional amount to intensify training efforts for the Performance Auditor I positions as well as training for the proposed auditor positions. With the additional amount we can maintain compliance with educational requirements under Government Auditing Standards and provide staff with the skills and training needed to continue producing audits with significant results.

Peer Review

We are requesting **\$5,000** for our Peer Review, which will be conducted in the Fall of 2013. Under Government Auditing Standards, we are required to have a review of our internal quality control system every three years to ensure adherence to standards. The Association of Local Government Auditors' peer review program satisfies this requirement. The cost associated with this review is approximately \$5,000 for travel, lodging and meals.

Other Information

An expense of \$793,739 for the Comprehensive Annual Financial Report (CAFR) audit performed by the external auditor, Macias Gini & O'Connell LLP (MGO), is included in the City Auditor's budget. This is the final CAFR year under the current contract; OCA will begin the process to select a CPA to conduct the CAFR audits in future years.

I look forward to discussing this request with the Audit Committee and thank you for your input and consideration.

Respectfully submitted,



Eduardo Luna
City Auditor

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| Expenditures by Category | Fiscal Year 2011 | | | Fiscal Year 2012 | | | Fiscal Year 2013 | | | Fiscal Year 2013 | | | Fiscal Year 2014 |
|--|---------------------|---------------------|-----------------------|---------------------|---------------------|-----------------------|---------------------|----------------------------|-----------------------|---------------------|-----------------------------------|-----------------------|--------------------------------|
| | Budget | Actual | Surplus/ (deficit) | Budget | Actual | Surplus/ (deficit) | Budget | Actual (as of 03.28.13) | Surplus/ (deficit) | Budget | Anticipated Expenses at FYE | Surplus/ (deficit) | Budget Additions Request |
| Personnel | | | | | | | | | | | | | |
| Salaries and Wages | \$ 1,633,127 | \$ 1,582,950 | \$ 50,177 | \$ 1,720,154 | \$ 1,664,031 | \$ 56,123 | \$ 1,758,631 | \$ 1,147,804 | \$ 610,827 | \$ 1,758,631 | \$ 1,689,047 | \$ 69,584 | \$ 368,268 |
| Fringe Benefits (calculated by FM) | 1,010,510 | 709,295 | 301,215 | 857,390 | 673,700 | 183,690 | 809,089 | 485,793 | \$ 323,296 | 809,089 | 734,034 | 75,055 | \$ 176,073 |
| Personnel Subtotal | 2,643,637 | 2,292,246 | 351,391 | 2,577,544 | 2,337,730 | 239,814 | 2,567,720 | 1,633,597 | \$ 934,123 | 2,567,720 | 2,423,081 | 144,639 | \$ 544,341 |
| Fringe as a % of Salaries and Wages | 62% | 45% | | 50% | 40% | | 46% | 42% | | 46% | 43% | | 48% |
| Non Personnel - Dept Operating Budg | 175,169 | 189,533 | (14,364) | 182,241 | 154,764 | 27,477 | 297,646 | 319,894 | \$ (22,248) | 297,646 | 319,894 | (22,248) | \$ 55,345 |
| Non Personnel Subtotal | 175,169 | 189,533 | (14,364) | 182,241 | 154,764 | 27,477 | 297,646 | 319,894 | \$ (22,248) | 297,646 | 319,894 | (22,248) | \$ 55,345 |
| Annual CAFR Audit Expense | 942,374 | 322,042 | 620,332 | 793,739 | 947,013 | (153,274) | 793,739 | 562,424 | \$ 231,315 | 793,739 | 562,424 | 231,315 | |
| Internal Control Report Expense | | | | | | | 150,000 | | \$ 150,000 | 150,000 | | 150,000 | |
| Non Personnel Total | 1,117,543 | 511,575 | 605,968 | 975,980 | 1,101,777 | (125,797) | 1,241,385 | 882,318 | \$ 359,067 | 1,241,385 | 882,318 | 359,067 | \$ 55,345 |
| Total | \$ 3,761,180 | \$ 2,803,821 | \$ 957,359 | \$ 3,553,524 | \$ 3,439,507 | \$ 114,017 | \$ 3,809,105 | \$ 2,515,915 | \$ 1,293,190 | \$ 3,809,105 | \$ 3,305,399 | \$ 503,706 | \$ 599,686 |

| Expenditures by Category | Fiscal Year 2011 Actual | Fiscal Year 2012 Actual | Fiscal Year 2013 Budget | Fiscal Year 2013 Actual as 3/28/2013 | Fiscal Year 2014 Budget Additions Request |
|------------------------------------|----------------------------|----------------------------|----------------------------|--|--|
| Personnel Costs | \$1,582,950 | \$1,664,031 | \$1,758,631 | \$1,147,804 | \$368,268 |
| Fringe Costs | 709,295 | 673,700 | 809,089 | 485,793 | 176,073 |
| Total Personnel | 2,292,246 | 2,337,730 | 2,567,720 | 1,633,597 | 544,341 |
| Supplies Cost | 19,249 | 11,379 | 15,708 | 9,826 | |
| Contracts/Services Cost | 118,214 | 52,669 | 103,741 | 91,246 | 34,944 |
| Information Technology Cost | 43,110 | 80,605 | 159,830 | 208,163 | 20,401 |
| Energy/Utilities/Other Cost | 8,960 | 10,111 | 18,367 | 10,659 | |
| Non-personnel Cost Subtotal | 189,533 | 154,764 | 297,646 | 319,894 | 55,345 |
| City CAFR | 322,042 | 947,012 | 793,739 | 562,424 | |
| City Internal Controls Report | | | 150,000 | | |
| Non-personnel Total | 511,575 | 1,101,776 | 1,241,385 | 882,318 | 55,345 |
| Total | \$2,803,821 | \$3,439,506 | \$3,809,105 | \$2,515,915 | \$599,686 |

Fringe Benefits Composition

- Retirement ARC
- Supplemental Pension Savings Plan
- Employee Offset Savings
- Worker's Compensation
- Flexible Benefits
- Risk Management Administration
- Long-Term Disability
- Unemployment Insurance
- Medicare
- Other Post-Employment Benefits
- Retirement 401 Plan
- Retiree Medical Trust