




THE CITY OF SAN DIEGO

**DATE:** March 19, 2008

**TO:** Honorable Mayor and Audit Committee Members

**FROM:**  Eduardo Luna, Internal Auditor

**SUBJECT:** Response to Jefferson Wells Report to the San Diego Audit Committee Best Practices, Analysis and Recommendations for: Risk Assessment Development, Annual Audit Work Plan Development, Internal Audit Function Staffing

On March 6, 2008, Jefferson Wells issued the above referenced report that made six recommendations pertaining to the Internal Audit function. Jefferson Wells reviewed and commented on the Internal Auditor's risk assessment, audit work plan, and Internal Audit staffing needs. I would like to thank Jefferson Wells for their report and recommendations for strengthening the Internal Audit function.

**Recommendation 1: The City of San Diego's Annual Risk Assessment should consider including additional risk factors.**

AGREE. As recommended, we will evaluate and incorporate as appropriate the recommended risk factors and others factors, such as "potential liability" in future risk assessments. The additional risk factors, such as management competence, degree of change, and timing of last audits were in fact considered for use in this year's risk assessment, but were excluded given the current government environment. Given the change in government structure and management personnel, business reengineering program, and limited past internal audits, the suggested risk factors would have yielded questionable results. The risk assessment was structured to give the highest weight to financial factors and quality of the internal control systems. In comparison to financial risk factors, the additional suggested factors would have been given low weights and may not have been yielded any noticeable differences in the final risk assessment outcome.

**Recommendation 2: The Annual Audit Work Plan should include detailed budget information.**

PARTLY AGREE. We agree that the annual audit work plan should include information pertaining to the planned audit hours. However, we disagree that we should include comments in the audit work plan regarding any additional budget needs to perform the requested work. None of the cities cited as comparison for best practices included budget information in the annual audit work plans. In local government, budget and staffing needs are addressed through the budget process. Internal Audit staffing and budget needs will be addressed during fiscal year 2009 budget process. We can provide budget information in future annual audit accomplishment reports or list the information in a public website.

In the proposed audit work plan, we did provide general time frames for our planned audits, such as target start and completion dates. In future Annual Audit Work Plans, we will include estimated audit hours and total staff audit hours available to perform the work. We recently provided more details on our budgeted audit hours in our monthly audit activity report. In addition, it was recommended that we list the type of audits that will be performed in our Work Plan. All of our audits fall under the category of "Performance Audit." A detailed explanation of this concept will be provided in future Annual Audit Work Plans.

**Recommendation 3: Internal Audit Staff Resources should be evaluated and increased.**

AGREE. Audit staff resources should be evaluated and increased. The current office staffing includes an Internal Auditor, an audit manager, and three auditors (five FTEs). Jefferson Wells' recommendation to increase Internal Audit staff to 24.5 Full Time Equivalent (FTE) positions is in line with my assessment of staffing needs. To have an effective and manageable auditing function, in my opinion, the City of San Diego should have at least 20 staff auditors, which would equate to 31,200 direct audit hours. In addition, the Office would need an additional audit manager and two staff support positions. An audit organization with 20 auditors should be able to complete between 50 and 75 audits per year.<sup>1</sup>

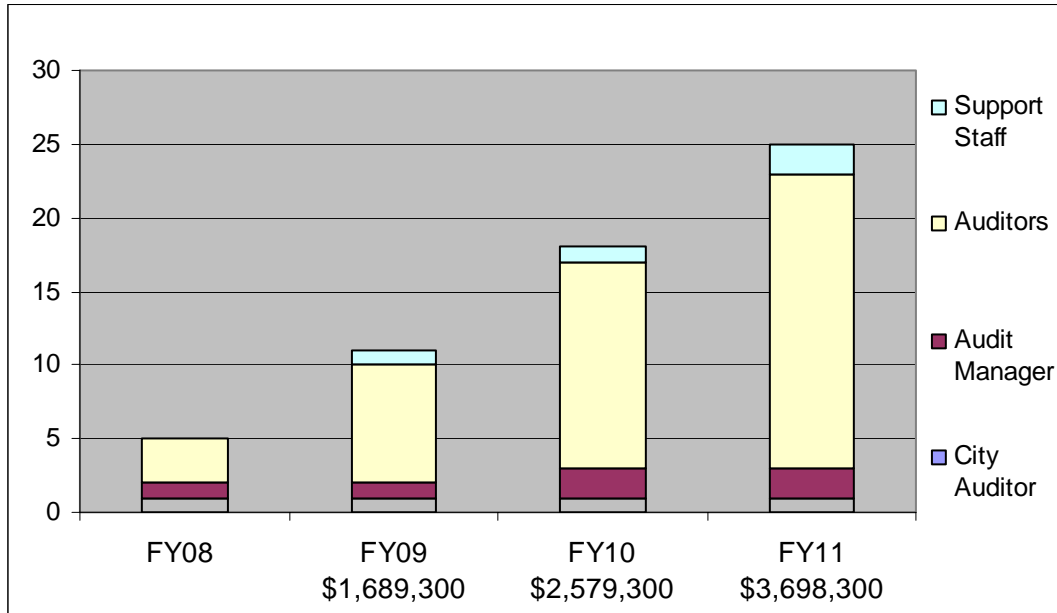
To reach the target of 20 auditors, the City needs to consider adding 17 auditor FTE positions strategically and in a manner that allows the new staff to be effectively managed and trained. Each FTE auditor position fully-loaded annual cost (salary, fringe benefits, and non-personal costs, such as desks, computers and training) is about \$148,000. The fully-loaded cost to add a staff support position is approximately \$83,000. Most audit offices measure performance based on a target of audits that identify cost-savings or potential for increased revenue recovery. The key decision is do you build up the audit organization over three years, four years, or an alternate timeframe?

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<sup>1</sup> The number of hours required to complete an audit in accordance with generally accepted government auditing standards generally can range from 200 hours to 2,000 hours or more depending on the audit objectives and scope, program size and complexity, and ability to obtain and analyze the relevant data. It is expected the audit office will undertake and complete a variety of audits within the above range of hours.

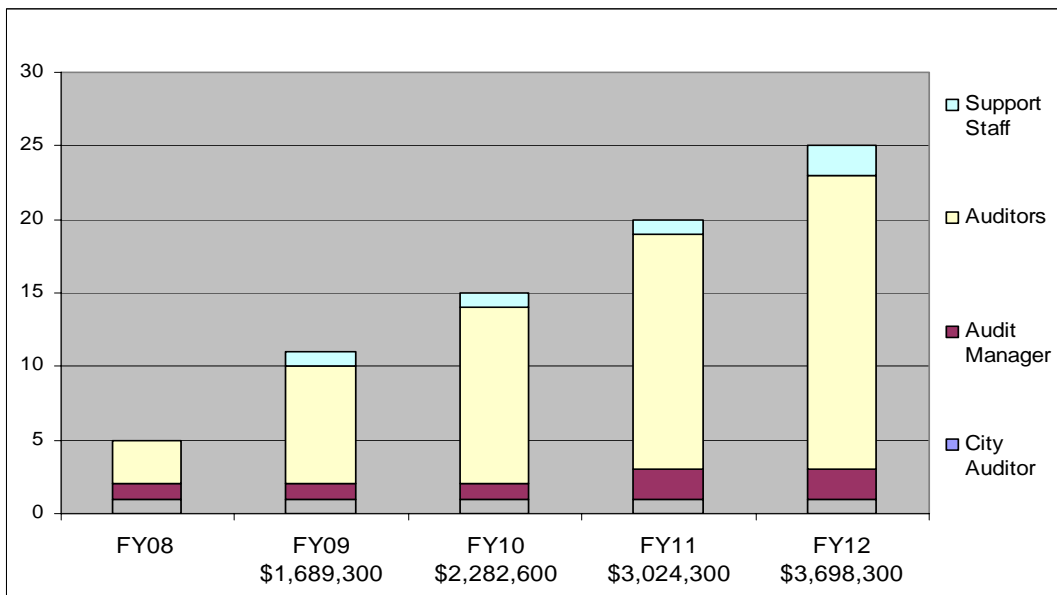
*Three Year Plan*

Under this scenario, the Office would increase by 17 auditors, one audit manager, and two support staff over three years. As shown in the below graph, the Office would grow by five, six, and six auditors in year one, year two, and year three, respectively. The annual cost to add five auditors and one support position is approximately \$825,000.



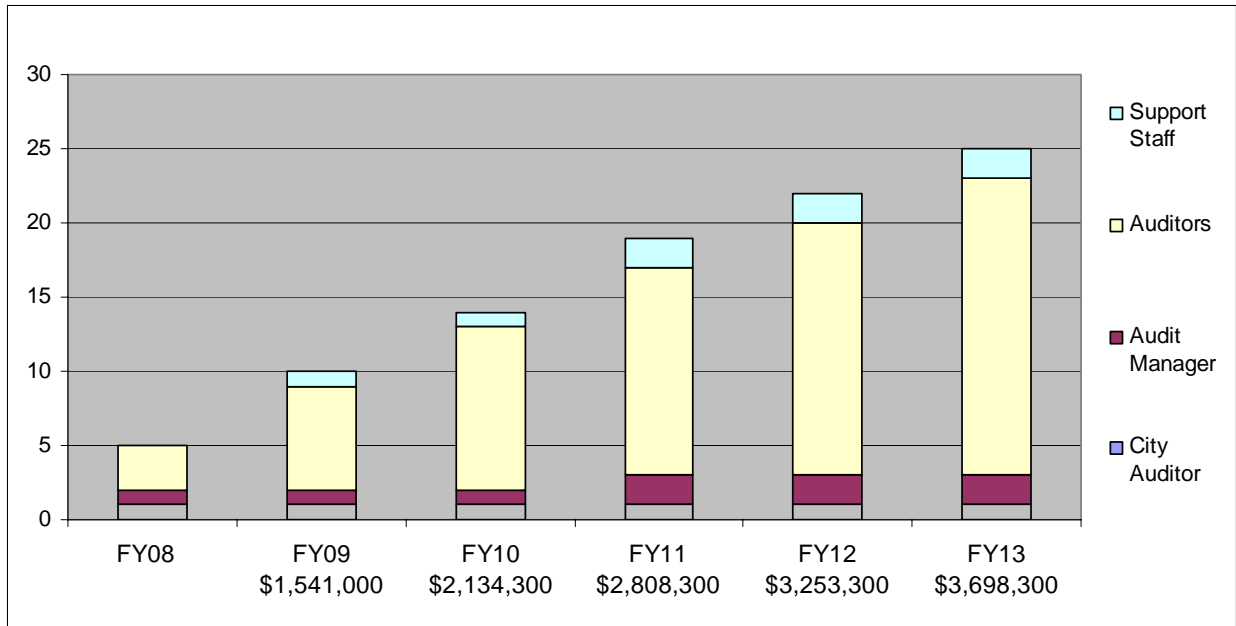
*Four Year Plan*

Under this scenario, the Office would increase by 17 auditors, one audit manager, and two support staff over four years. As shown in the below graph, the Office would grow by five auditors in year one, and four auditors in the remaining years. The annual cost to add five auditors and one support position is approximately \$825,000.



*Five Year Plan*

Under this scenario, the Office would increase by 17 auditors, one audit manager, and two support staff over five years. As shown in the below graph, the Office would grow by four auditors in year one and year two, and three auditors in years three to five. The annual cost to add four auditors and one support position is approximately \$677,000.



To have an impact of reducing risk to the City, I propose adding at least five FTEs auditor positions in fiscal year 2009, plus an additional support staff position. Five additional audit positions would allow me to complete up to 15 additional audits. The number of audits completed will be impacted by the ability to recruit and hire staff on a timely basis. I would expect to hire a mix of experienced and entry level auditors.

We should note that the current Internal Audit office is located in a private office building located at 600 B Street, Suite 1440. We have two available offices; a conference room that can be converted into cubicles for three auditors; and space for a support position. If the office were to increase beyond 11 FTE's in fiscal year 2009 or beyond, the current office space would be insufficient and alternative office space will be needed.

**Recommendation 4: IT auditor needed for the Annual Audit Work Plan's proposed Enterprise Resource Planning (ERP) audit.**

AGREE. As shown in my Audit Work Plan, Jefferson Wells concurred that the Internal Audit Department should be actively involved in the ERP implementation process<sup>2</sup> to assure that internal control considerations have been adequately addressed, and to start an immediate search for an IT auditor. However, these additional personnel expenditures

<sup>2</sup> Once implemented, OneSD ERP project is expected to improve San Diego's financial management system and enhance internal financial controls.

will need to be approved by the Mayor and City Council before I can begin recruiting additional audit staff with IT experience.

As an alternative to recruiting and hiring an IT auditor, I have identified one staff person who possesses basic IT auditing skills, who could be trained specifically in auditing the SAP implementation. My plan is to send this auditor to the Institute of Internal Auditors Introduction to Auditing SAP ERP training course. The course is scheduled for May 12-16, 2008, in Boston, MA. The training course and related expenses is an estimated \$5,850. A SAP audit consultant could also be brought in to assist the IT auditor in the review of the SAP system. I have also contacted other jurisdictions that have implemented SAP and obtained relevant audit procedures that we can utilize in auditing the implementation. However, reassigning this staff person to review the ERP implementation will delay the completion of our work on testing internal financial controls by at least three months.

**Recommendation 5: The Annual Audit Work Plan should include an expanded “limitations” statement.**

AGREE. In my proposed Audit Work Plan, I included a modifying statement that in my opinion is appropriate. I stated: “We designed our work plan to address what we considered to be the highest priority areas, while limiting the scope for work that we can realistically accomplish with the staff resources available.” This statement is consistent with what you will find with many other local government Audit Work Plans.

The Government Auditing Standards that I follow also provide for a limitations statement. Specifically, Government Auditing Standards requires a limitations statement in audit reports if external impairments restrict the auditors’ ability to form independent and objective audit opinions, findings, and conclusions. In some situations, restrictions on funds or other resources that adversely affect the audit organization’s ability to perform work could be considered an external impairment.

Further, during the current fiscal year 2009 budget process, the Audit Committee, the City Council and City Management will be made aware of the Audit Department’s limited staff resources so they can take appropriate action. If limited audit resources remain an issue, I will consider an expanded limitation statement in the Annual Audit Work Plan.

**Recommendation 6: The Audit Committee should receive an Annual Internal Audit Status Report.**

AGREE. I plan on producing and issuing an Annual Accomplishments Report to the Audit Committee, City Council Members, and appropriate members of City management as Jefferson Wells recommended. The report will include a summary of our audit activities, accomplishments, and recommendations and show how our audit work helped assess and control the City’s risk.

Generally Auditing Standards has a requirement pertaining to the reporting of internal control deficiencies. Specifically, the standards require that when conducting performance audits, auditors need to gain an understanding of the applicable internal

controls. Auditors are required to report on internal controls and any deficiencies in internal controls that are significant within the context of the audit objectives and based upon the audit work performed. My plan is to include in the Annual Accomplishments Report information on any significant deficiencies identified in internal controls and recommendations made to correct those weaknesses.

Eduardo Luna  
Internal Auditor

cc: Honorable City Council Members  
Jay M. Goldstone, Chief Operating Officer  
Andrea Tevlin, Independent Budget Analyst  
Stan Keller, SEC Consultant