



MEMORANDUM

Item No.: 4

City Manager/Finance

DATE: 12/15/2011

TO: CHARTER REVIEW COMMITTEE

FROM: PAUL C. SUNDEEN, ASSISTANT CITY MANAGER/CFO

CC:

RE: INTERNAL AUDITOR APPOINTMENT/REPORTING RESPONSIBILITY

SUMMARYRECOMMENDATION:

The Charter Review Committee ("CRC") has discussed a possible Charter amendment relative to the appointment and oversight of the Internal Audit function. Staff's recommendation to the CRC is no change to the appointment and reporting structure, but adding confirmation by the City Council of the appointment made by the City Manager. Additionally, periodic reporting to the Finance Committee of the results of its audits is recommended.

BACKGROUND:

The audit requirements of the City can be split into two separate functions – an external audit function and an internal audit function. The external audit function is mandated by State law and performs required financial audits in which they report as to whether the accounts of the City reasonably reflect the City's financial position. They are required to report to a body (currently the Finance Committee) regarding the outcome of their audit work. While the scope of their work is typically the same from one municipal organization to another, they are able to provide independent, financial audit services for any additional services deemed necessary by the Finance Committee and/or City Council.

The internal audit function is focused on performing audits that are either operational or compliance based. The objective is to find inefficiencies or instances of non-compliance and make recommendations to improve those conditions. Staff's recommendation is based on its belief that the internal audit function best serves the City's needs in the current organizational structural. It serves as a resource of the City Manager to identify areas for improvement as he endeavors to manage the City in the most cost effective and efficient manner. Under the current structure, the City Council can request the Internal Auditor to review any program or expenditure it believes merits attention.

The prospect of elevating the internal audit function to a Charter position appointed by the City Council has a likely outcome of growing the program, which would have a substantially greater cost, borne by the General Fund. More staffing of the internal audit function may be a positive direction, but its growth needs to be considered within the context of the full General Fund budget.

The following two options have been prepared by staff, based upon direction given by the Charter Review Committee at the November 28, 2011 meeting

OPTION A: Original proposal presented by City staff (modified to be appointed by and report to CC)

Sec. 700. Appointment of City Attorney, ~~and~~ City Clerk and City Auditor by Council; tenure.

In addition to the City Manager, there shall be a City Attorney, ~~and~~ a City Clerk and a City Auditor who shall be appointed by and serve at the pleasure of the City Council.

New: Sec. 705. City Auditor

There shall be a City Auditor appointed by the City Council who shall have power and shall be required to:

- (a) Supervise and administer the City's internal audit division.
- (b) Coordinate, plan, and perform financial and performance audits of City operations and functions as requested by the City Council or City Manager.
- (c) Plan, budget, and schedule audit assignments to ensure that audit objectives are met in accordance with generally accepted auditing standards.
- (d) Report on all findings in detail to the City Manager and in summary to the City Council's Finance Committee.

OPTION B: Sacramento model (appointed by CC, powers and duties set by ordinance)

Sec. 700. Appointment of City Attorney, ~~and~~ City Clerk and City Auditor by Council; tenure.

In addition to the City Manager, there shall be a City Attorney, ~~and~~ a City Clerk and a City Auditor who shall be appointed by and serve at the pleasure of the City Council. The powers and duties of the City Auditor shall be set by ordinance.

Examples of Powers and duties of the City Auditor (to be set forth in ordinance):

1. The City Auditor shall be a certified public accountant, a certified internal auditor, or have such other or additional qualifications as the City Council may establish by resolution. The City Auditor shall set the qualifications for subordinate staff.
2. By March 1st each year, the City Auditor shall submit an annual audit plan to the City Council for approval. The annual audit plan may be amended during the year with the approval of the City Council. The City Council may, by resolution, authorize a committee, charter officer, or an individual Councilmember with respect to the Councilmember's own office, to request additional audits.
3. Audits shall be conducted in accordance with standards as prescribed by City Council resolution.
4. The City Auditor shall prepare a written report of the results of each audit conducted and will be responsible for retaining a copy as a permanent record. The City Council may prescribe by resolution the manner of report preparation and presentation.
5. City departments, offices and employees shall provide the city auditor access to all sources of information, property, and personnel relevant to the performance of an audit, unless restricted or prohibited by law. This section shall not apply to the office of any elected official, unless that elected official requested the audit, of that official's own office.
6. No person shall directly or indirectly coerce or attempt to coerce the City Auditor relative to the City Auditor's examinations, audits, or the appointment or removal of any employee which is made by the City Auditor.

Date: December 2, 2011

From: Monty Van Wart
Charter Review Committee Member

To: Charter Review Committee

RE: Internal Audit Functional Reporting and Citizen's Audit Committees

Dear Charter Committee Colleagues:

I write to you as we move toward our deadline for completing our tasks. Perhaps the largest issue still in front of us is regarding the possibility of turning the internal auditor into being a charter officer and adding a citizen's audit committee. While I have personal preferences on the issue which I will voice in our deliberations, I am concerned that the issue has become unclear. The following is an understanding of the landscape of this issue as a public administration generalist.

Rationale for Independent Review of Financial Functions. At its heart, the critical issue of concern is the accounting principle of separation of duties to ensure that financial execution and review are not overseen by the same person. Size of the operations plays an important role here. For example, if the agency is composed of a dozen people, the receipts must be done by one clerk and the deposits by another. The issue of separation of duties applies not only to the prevention of fraud, but also in order to the assurance that financial management is accessible to external review and consideration to ensure that financial policies are being properly and prudently executed even where there is no intent for fraud or gross mismanagement. As organizations become more complex, however, the separation of financial duties is often placed in different divisions or agencies, and the measures to ensure that the policy board or legislative body have direct access to fiduciary correctness outside normal administrative reporting channels becomes even more important. For example, in a complex organization like the federal government, there is the independent General Accountability Office (3000+ personnel) that reports to Congress, as well as 73 Inspectors General who are nominated by the President, as well as internal audit functions in larger agencies. Many jurisdictions have independently elected officials who have an audit function as their prime responsibility or as a part of a portfolio of responsibilities (e.g., combined treasurer-auditor and comptroller-auditor functions are common). Generally speaking, separation is considered greatest when the auditor is elected, moderate when the auditor reports to the policy body/legislative body, and weakest when it reports to the executive officer or an administrative subordinate of the executive officer.

Background for the Interest on an enhanced audit position. The public's heightened interest in independent audit functions has grown in both the private and public sector, but for differing reasons. On the private sector side, a series of major financial scandals led to the passage of Sarbanes-Oxley Act of 2002 which strengthened both external and internal audit controls for publicly traded companies. Problems of insufficient separation of functions and audit independence led to massive fraud, oversights, and claims of executive ignorance. On the public sector side, the California scandals in Bell and Vernon have touched a national nerve recently, as have the international public finance concerns in Europe. The Orange County default (1994) was also unusual, and it reminded the public and bond markets that sovereign accounts can default. Although the public's concern for public sector accounting transparency has increased tremendously, there has been little concrete evidence beyond a very limited number of cases that public sector auditing failures have been frequent or widespread. Exceptions

include the Department of Defense with its enormous and highly political contract budget and large federal programs such as occurs in bogus Medicare billings. Of course, the public's concern can be considered its own rationale and the bar for transparency and fiduciary compliance in the public agencies is exceedingly high because the stakes are so important and long-term.

Functional roles: There are a number of functional roles, some of which can be disaggregated or combined. Those roles include:

1. External auditor: this is required by law. While the scope of the audit may vary and sometimes may be expanded, it looks at fiscal soundness in general, as well as financial controls. Enterprise funds are often subject to a separate audit. This is essentially a high-level, after-the-fact function, as well as a confirmation of system integrity at a global level. Detailed analysis of the audit function must be separately commissioned and is unusual. This function (review of the CAFR: Comprehensive Annual Financial Report) must be functionally separate and independent.
2. Internal audit: internal audit may be limited to financial investigation, but frequently includes performance reviews as well. It looks at ongoing operations on either a cyclical basis or based on requests from the legislative body or the administration due to policy changes or perceived problems. It is sometimes separately elected (e.g., Los Angeles or Oakland). It sometimes reports to the legislative body (e.g., the General Accountability Office whose head is the Comptroller General of the U.S., and cities such as San Diego and San Jose) and sometimes to the administration (e.g., cities of Fresno and Riverside). Sometimes the functions of tax collections and payroll are combined with auditing (e.g., State Controller or County of Riverside Auditor-Controller).
3. Audit and finance committee functions are various and can be disaggregated or combined, according to structural preferences of the jurisdiction. In the City of Riverside, these functions are combined under the Finance Committee, a standing Council Committee function.
 - a. Companies and public sector entities are required to have independent audit committees to select, task, monitor, and review the findings of the external auditor. In the public sector, these external audits are largely restricted to the review of the CAFR and enterprise funds.
 - b. Organizations have committees that review internal audit functions that are relatively detailed and technical in nature.
 - c. Organizations have committees that review upcoming and ongoing budget expenditures.
 - d. Organizations have committees that look at performance and policy reviews.
 - e. Sometimes organizations have citizen boards and commissions that review finances and audit functions (e.g., City of New Haven's Financial Review and Audit Commission and the City of Irvine's Finance Commission). This is generally a duplicative function that is meant to add citizen input and transparency into a technical area. While not very common, it is not rare.

In my opinion, **the major issue is choosing among the following options:**

1. Do we want to consider the view of some that it is time for increased independence and/or outside review of the financial audit function? If so, the four major options being considered by us at this point are:
 - a. To make the auditor a charter officer reporting to the Council or the Finance Committee with primarily financial and performance responsibilities, but other responsibilities as well that are assigned by Council.

- b. To provide a charter citizens' Audit Committee.
- c. To provide both a charter auditor officer and an audit.
- d. To provide neither a charter auditor officer or citizens' audit committee.

In my opinion, **the following issues are not a significant part of the discussion:**

- 2. The Council's Finance Committee will be largely unaffected by either an internal auditor reporting to the Council or an additional citizen review committee. Indeed, the Finance Committee's oversight of the internal audit function would be structurally strengthened by making the internal auditor a charter officer.
- 3. Enlargement of staffing or duplication for a charter auditor officer. There need be no additional staffing since an internal audit function with sufficient staffing already exists for a city the size of Riverside. It would essentially be a transfer of functional responsibilities from the executive branch to the legislative branch as is commonly done in this area.
- 4. Precedent for charter auditor. The bulk of the larger cities in California and indeed the nation have moved to an independent auditor, either by election or Council appointment. For example, the City of Modesto moved to a council-appointed from a management-appointed auditor in 2008. This does not imply the City of Riverside must or should take this step; it is only to say it would be in line with the national trend and part of a growing common practice.

Appendix:

Principal CA Cities

Auditor reporting status

Name			
1	Los Angeles	3,792,621	Elected
2	San Diego	1,307,402	Audit Committee (Council Committee)
3	San Jose	945,942	Council
4	San Francisco	805,235	Council (Controller)
5	Fresno	494,665	<i>City Manager</i>
6	Sacramento	466,488	Council
7	Long Beach	462,257	Elected
8	Oakland	390,724	Elected
9	Bakersfield	347,483	<i>City Manager/Finance (also have treasurer)</i>
10	Anaheim	336,265	<i>City Manager (also have treasurer)</i>
	Riverside	303,871	<i>City Manager/Finance Director</i>
	Stockton	291,707	Council
	Modesto	201,165	Council
	Berkeley	112,580	Elected

Sources: Memorandum from Cheryl Johannes to Paul Sundeen (July 28, 2011) and additional review of city websites by author.

Proposal for Appointed City Auditor:
Submitted by Study Review Committee

Appointment of City Auditor

The City Council shall appoint the City Auditor who shall serve at its pleasure. The City Auditor shall be certified according to standards comparable to a Certified Public Accountant or a Certified Internal Auditor at the time of appointment.

Powers and Duties

The City Auditor shall have the following powers and duties:

- 1) Conduct or cause to be conducted annual post audits of all the fiscal transactions and accounts kept by or for the City. Such audits shall include but not be limited to the examination and analysis of fiscal procedures and the examination, checking and verification of accounts and expenditures. The audits shall be conducted in accordance with generally accepted auditing standards and accordingly shall include tests of the accounting records and other auditing procedures as may be considered necessary under the circumstances. The audits shall include the issuance of suitable reports of examination so the Council and the public will be informed as to the adequacy of the financial statements of the city.
- 2) Conduct performance audits, as assigned by Council. A “performance audit” means a post audit which determines with regard to the purpose, functions and duties of the audited agency all of the following:
 - a) Whether the audited department, office or agency, is managing or utilizing its resources, including public funds, personnel, property, equipment and space in an economical and efficient manner.
 - b) Causes of inefficiencies or uneconomical practices, including inadequacies in management information systems, internal and administrative procedures, organizational structure, use of resources, allocation of personnel, purchasing policies, and equipment.
 - c) Whether the desired results are being achieved.
 - d) Whether objectives established by the Council or other authorizing body are being met.
- 3) Conduct special audits and investigations, as assigned by Council. “Special audits and investigations” mean assignments of limited scope, intended to determine:
 - a) The accuracy of information provided to the Council.
 - b) The costs and consequences of recommendations made to the Council.
 - c) Other information concerning the performance of City Departments, Offices or Agencies as requested by the Council.

Revised 12/06/11

- 4) The City Auditor shall have access to, and authority to examine any and all documents including but not limited to books, accounts, internal memoranda, writings and tapes, reports, vouchers, correspondence files and other records, bank accounts, money and other property of any City department, office or agency, whether created by the Charter or otherwise, with the exception of the office of any elected official.

It is the duty of any officer, employee or agent of the City having control of such records to permit access to, and examination thereof, upon the request of the City Auditor or his or her authorized representative. It is also the duty of any such officer, employee or agent to fully cooperate with, and to make full disclosure of all pertinent information.

- 5) Prepare and submit to the Council quarterly reports of the City Auditor's activities and findings in the immediately preceding three calendar months, together with any recommendations to improve the administration of the City.
- 6) Perform other auditing functions, consistent with other provisions of this Charter, and prepare and submit such other reports, as may be assigned by the Council.

Power of Appointment

The City Auditor may appoint and prescribe the duties of the professional, technical and clerical employees employed in the Office of the City Auditor; provided, however, that the City Auditor shall not appoint to any position any business associate or any person related to him or her or to the City Manager or to any member of the Council by blood or marriage within the third degree, except that the foregoing prohibition against nepotism may be waived by a vote of at least two-thirds (2/3) of the members of the Council if the Council finds that the proposed appointment is in the interest of the City. All such appointees shall serve at the pleasure of the City Auditor in the unclassified service; and shall serve under such terms and conditions, salaries and benefits as are similar to other unclassified employees;

Neither the Council nor any of its members shall in any manner dictate the appointment or removal of any such officer or employee whom the City Auditor is empowered to appoint, but the Council may express its views and fully and freely discuss with the City Auditor anything pertaining to the appointment and removal of such officers and employees.

Citizens Audit Committee

There shall be a Citizens Audit Committee composed of seven to nine volunteer Riverside residents with financial expertise and no financial ties to the City. Committee members shall be selected by the City Council and report to the Internal Auditor. The Committee shall meet quarterly and shall have the power to review and comment on the internal Auditor's reports to the City Council and to make recommendations for future reports.

The Internal Auditor and the Citizens Audit Committee shall be appointed no later than December 31, 2012

From: Joan Donahue [mailto:donahue.joan@att.net]
Sent: Thursday, December 15, 2011 8:40 AM
To: Nicol, Colleen
Subject: Comments/CRC/Internal Independent Auditor



December 15, 2011

Hi Colleen -

Could you please forward this information to the Charter Review Commission.

Our League sent a few questions to League of Women Voter's Presidents in cities that employ auditors who report to city councils, seeking their League's assessment of those offices. The cities include [San Jose](#), [Sacramento](#), [Long Beach](#), and [Oakland](#). I'll tell the Committee more about their comments at the next CRC meeting on Monday.

Attached are remarks from the City Auditors of [Berkeley](#) and [Stockton](#). Berkeley's auditor is elected, Stockton's is appointed by the City Council.

All of these City Auditors answer to their City Councils and this is key - the Institute of Internal Auditors' guide, [The Role of Auditing in Public Sector Governance](#), lists "organizational independence" as the first component in effective public sector auditing.

We hope Committee Members will take a moment to check out the differences between [Riverside's Auditor's Office](#) and the [process](#) and [reporting](#) of the City of Stockton, which is typical of cities who employ an Auditor who reports to the City Council.

We greatly appreciate the Committee's emphasis on gauging the public's interest in issues, as logically, those with the most interest should move forward. However, there are trends outside Riverside that are proving popular and advantageous to local government operations and we hope the Committee will consider moving a recommendation like this one forward, as well.

As I recall, Council Member Davis stated in his interview with the Committee that he supported this change in our Auditor's reporting line, while Council Members Bailey and Melendrez suggested it might warrant further consideration.

Thank you,

Joan Donahue, President
League of Women Voters Riverside
(951) 686-0562
donahue.joan@att.net

----- Original Message -----

From: [Ann Marie Hogan](#)

To: 'Judd & Sherry Smith'

Cc: ahogan@cityofberkeley.info

Sent: Sunday, December 11, 2011 3:23 PM

Subject: RE: LWV Riverside/Berkeley City Government Question

I am delighted to learn that Riverside is considering improving the independence of their existing audit function. This should help the office become more effective, and, if enshrined in the City Charter, or at least in municipal code, will help prevent some future City Manager from eliminating the office (which often happens with auditors who can be hired and fired by the City or County Manager).

Government Audit Standards are issued by the U.S. Comptroller General and the Government Accountability Office - GAO, the legislative audit arm of Congress - and they are very specific about the necessity to ensure independence.

As it happens, I am on the Advocacy Committee for the Association of Local Government Auditors (ALGA). Back when I was chairing the committee I made two presentations to the San Diego City Council to help them decide on ballot language when they were advised (by outside auditor/investigators) that their audit function should be changed so that it could follow Government Audit Standards and be more independent.

I am still the contact for California for the committee, and so I'd be happy to make sure that we write a letter to the League and/or the Charter Review committee, and also to send a speaker.

You can learn more about ALGA on their [web site](#) This [brochure](#) is also helpful.

See the [GAO](#) and the "yellow book" (our audit standards).

In answer to the Riverside's League questions:

Did Berkeley create its independent auditor's office because of a specific incident or trend? If there was a problem, has it been corrected or alleviated by the independent office?

The Berkeley Auditor was set up in the original City Charter - it's the oldest Charter position in Berkeley. It was set up originally as a Controllorship function, with all checks and all contracts to be signed by both City Manager and City Auditor.

In the early seventies (or so) performance auditing was established at the federal government level, and because local governments were starting to get a lot of federal grants and so were in need of much more oversight, cities such as Berkeley began retrofitting their existing "audit" functions to start doing actual audits.

There was no "right to audit" clause in the Charter, the Council put a measure on the ballot in 1998. Section 61 of the City Charter contains both the old "controllorship" language and the new language.

Do citizens trust the office to provide accurate and unbiased reports and analysis?

I believe they do. Especially since we issued our report on unfunded pension liabilities, even those stakeholder groups who are historically very hostile to City staff and suspicious of their statements have publicly expressed confidence in our work.

Do you think the office improves transparency? Efficiency?

There's no question that there is increased transparency because my reports go to Council and are posted on the web site (unlike most reports of auditors who report to management).

I try to do some efficiency-oriented audits each year, some fraud-prevention work, and some "Transparency" work such as the pension benefits audit and the streets audit. I'm presenting my annual report to Council on Tuesday, and it talks about what we accomplished last year.

My [website](#) has recent reports.

Do citizens feel comfortable working with the office and bringing forward any complaints about fiscal management?

Well, I do get many complaints and suggestions! If I count up the citizen audit suggestions and complaints and add them to the list of audit suggestions from City staff, it's in the hundreds.

Ann-Marie Hogan
City Auditor
City of Berkeley
2180 Milvia Street, 3rd floor
Berkeley, CA 94705
(510) 981-6750

(more)

From: Mike Taylor [mailto:Mike.Taylor@stocktongov.com]
Sent: Wednesday, December 14, 2011 4:38 PM
To: Joan Donahue
Subject: Re: Riverside, CA/Office of Independent Auditor Proposal

Joan,

I'm honored that you would ask for my comments about changes to your City's charter to create a City Council appointed City Auditor. Hopefully my input will be of use to you and the City.

Following are my comments on the questions you have raised, along with a few additional thoughts.

When Stockton created your office in 1994, was it because of a reaction to problems with auditing or was the Council looking to generally improve its City government?

Your question is a bit of a twist on the usual question. People usually want to know if the office was created following a major fraud or other scandal. The answer to that is no.

For some years before our office was created, there was an audit function in the Finance Department with two auditors. Originally, their work focused on auditing for revenue (e.g. business license, transient occupancy tax, etc.). At some point, the Finance Director had them stop doing revenue audits and moved to something like internal audits.

Because his office was doing audits, the Finance Director was able to persuade the City Council to make him a City Council appointee in order to create independence between auditing and the City Manager. With turnover in the City Manager position, the new City Manager proposed returning Finance to City Manager control and creating a City Auditor position that would report to the City Council.

Do citizens trust the office to provide accurate and unbiased reports and analysis?

As far as I know, they do. Certainly their elected representatives do. The local press and the civil grand jury trust our work and have been complimentary.

Also, our office undergoes a peer review every three years, as required by Government Auditing Standards. Auditors from around the country audit our procedures and examine samples of our audit work to determine if we are following the standards. Their audit of our office adds credibility to the reports we issue.

Do you think the office improves transparency? Efficiency?

We do improve transparency. Our reports are public documents and they are discussed in public meetings. Many of our findings point out the need for improved transparency, and we track findings until corrective action is taken.

Much of our work is directed at improving efficiency. When we recommend improvements in internal control, it is not to add a layer of bureaucracy. Good internal controls reduce cost by reducing risks and errors that are costly to correct. A good example of work directed at efficiency would be our audits in the Library system.

Do citizens feel comfortable working with the office and bringing forward any complaints about fiscal management?

On this point, an office structure like Berkeley will outshine ours. We don't have all that much contact with the general public. We work primarily with their elected representatives. I also worked in Roanoke, Virginia where the audit structure matched the Stockton organization. The same was true there.

Our office did engage the public concerning the City's budget and budget priorities two years ago. Working with students from UOP, citizens participated in focus groups, and we conducted a broad based on-line survey. We had good citizen participation.

Additional comments:

Creating or significantly modifying an audit function following a financial scandal is not the best timing. It can give the appearance that the function is only there to catch people stealing or doing very bad things. Employees and management are much more on guard, so the effectiveness of the audit function can be lessened.

The last line of your proposed audit charter refers to "Internal Auditor." As you are proposing to structure the function, the auditor would not be an internal auditor, as defined by Government Auditing Standards. Internal auditors report to management. A reporting relationship to the City Council is considered an external auditor.

You may also want to consider requiring a super majority vote of the City Council to fire the City Auditor. My work here has not been impacted by the fact that it only takes 50% plus one to fire me, but having a super majority requirement could strengthen the appearance of independence.

If you have any other questions, or need additional information, please feel free to contact me. Due to furloughs and holidays, our offices will be closed from December 21 until January 3. I'll probably be checking messages from time to time, but not on a regular basis.

Best of luck,
Mike
Mike Taylor, City Auditor
City of Stockton
mike.taylor@stocktongov.com
(209) 937-8918