



CITY COUNCIL AGENDA REPORT

MEETING DATE: APRIL 17, 2012

ITEM NUMBER: OB-1

SUBJECT: IMPLEMENTATION OF ANNUAL PERFORMANCE AUDIT PROCESS

DATE: APRIL 6, 2012

FROM: CHIEF EXECUTIVE OFFICE

PRESENTATION BY: RICK FRANCIS, ASST. CEO

FOR FURTHER INFORMATION CONTACT: Rick Francis @ (714) 754-5099

RECOMMENDATION:

Approve implementation process for performance audit function.

BACKGROUND:

Council Member Mensinger requested that the City Council consider creating an annual performance audit process. The interest is to annually review selected service areas within the city government structure to ensure they are performing as efficiently as possible.

On March 6, 2012, the City Council approved in concept the performance audit function and directed staff to return with a detailed implementation plan of how to devise the performance audit role, how to prioritize project tasks and determine reporting protocols. Specifically, the Council direction was to:

- Direct staff to prepare a staff report for discussion at a future City Council meeting where the City Council considers:
 1. Defining the authority and role of the Performance Auditor;
 2. Determining the scope of work, activities and desired outcomes of the performance audit function;
 3. Authorizing an annual performance audit work plan process to determine which service areas will be audited and in what sequence;
 4. Implementing a communication plan to inform City staff and residents about the role and potential benefits of the performance audit function; and
 5. Determining reporting protocols once an audit is completed;
- Authorize staff to initiate a process to obtain informal proposals for services from consultants;

- Authorize staff to include an allocation of \$100,000 from the contingency account for one or more performance audit reviews; and
- Select a consultant or firm to perform requested services.

ANALYSIS:

The following is a summary of the mechanisms that are suggested in order to implement the performance audit function:

Definition of Authority and Role of Performance Audit Function:

Authority granted to the performance audit function shall be derived from the City Council and the Chief Executive Officer. When the Performance Auditor is formally assigned a task by the Council, that person will work through the CEO to conduct the audit according to government auditing standards established for this role. The Performance Auditor shall have timely access to all pertinent records, policies and procedures, working documents or any other relevant information that will allow them to complete the task assigned within the specified scope of work.

Scope of Work:

The City Council, in collaboration with the Chief Executive Officer, shall enumerate the scope of work for each task assigned and provide general comments on desired outcomes. In order to achieve the scope of work assigned, performance audit activities may include surveys (initial assessment of area under review), testing, interviews, literary review (determining best practices), observation of work processes and data analysis. The desired outcome is always determining whether the area being audited can be improved and if so, how?

Performance Auditing measures an entity's goals and objectives, reliability, efficiency, control, effectiveness and compliance. Thus, in developing the scope of work, the Council and the CEO should consider the following:

Does the entity being audited ensure that economy and efficiency are of primary consideration in their particular business plan?

1. Does the entity have clearly stated goals and objectives that are SMART (specific, measurable, attainable, relevant and time-bound) in nature?
2. Do they establish, measure and report performance goals?
3. Do they follow sound procurement practices?
4. Do they acquire the appropriate type, quality and amount of resources at an appropriate cost?
5. Do they avoid duplication of effort by employees and work that serves little or no purpose?
6. Do they avoid idleness and overstaffing?
7. Are they in compliance with pertinent laws and internal policies?
8. Are there proper management controls in place that measure the entity's economy and efficiency?

The scope of work for each different audit will assume varying characteristics and areas to be measured based on their specific role within the City. As a practical matter, the City Council and the CEO will select areas to be audited (see Annual Work Plan section below) and the CEO will confer with the Performance Auditor in developing the specific scope of work for each audit area. Once the scope of work is determined, the audit can be initiated.

Annual Work Plan:

An Annual Work Plan should be developed by the City Council in cooperation with the CEO at a mutually agreed upon time of the year. It may be preferable to develop this plan each April so that auditing activities may be considered during the budget process. The Annual Work Plan may be formulated as follows:

1. The Council and CEO will determine suggested areas for review throughout the year and specifically during the first budget study session.
2. Council and CEO preferences will then be plotted on the Weighted Risk Assessment (attachment A) by staff and a tentative Annual Work Plan will be developed. (The Weighted Risk Assessment is designed to help the Council and CEO determine the priority in which audit activity should be completed by considering a number of risk components.)
3. The Council will then ratify or modify the tentative Annual Work Plan as part of the budget adoption process.
4. Should concerns arise outside of the normal audit schedule, Ad Hoc recommendations for performance audits must be requested in writing by at least two (2) council members and approved by the full Council at the next scheduled City Council meeting.

Communication Plan/ Reporting Protocols:

Upon implementation, a letter to the City organization from the Mayor will be formally sent out introducing the performance audit function. The letter will help in establishing the presence and authority of the function and provide clarity to the benefits that it will provide to the City. The letter will lay out the "working together" philosophy and encourage everyone to consider utilizing the Performance Auditor to explore additional ways to ensure efficiency.

Staff recommends that the Performance Auditor meet monthly with the CEO to discuss audits in progress or those that have been completed. In addition, the Performance Auditor should deliver a status report to the Council at least on a quarterly basis to discuss completed audits and recommendations from the Performance Auditor. This status report will provide Council members the opportunity to give collective direction on additional audits that should be added to the work plan. Reports dealing with sensitive personnel matters or legal issues may be agendized for closed session when necessary and as authorized by law. The Council will refer recommendations to the CEO for implementation as appropriate. These reports would also serve to keep members of the public apprised of performance audit activities in a timely and efficient manner.

The CEO's office will take steps to identify appropriate office space for contractors conducting work at city hall.

Selection Process

Staff recommends that Council authorize a Request for Qualifications (RFQ) process in order to build a list of qualified vendors. At a minimum, the selected vendor should meet the following qualifications:

1. Extensive knowledge and experience in the area of both fiscal and management auditing;
2. A working knowledge of municipal accounting principles and modern management and reporting practices;
3. A track record of demonstrated and meaningful leadership capability;
4. Superior written and verbal skills;

5. Ability to establish rapport and cordial working relationships with key personnel, departments and agencies being audited, while at all times maintaining a posture of objectivity and independence;
6. MBA or MPA desirable; and
7. (CPA) Certified Public Accountant and/or (CIA) Certified Internal Auditor preferred.

FISCAL IMPACT:

At the March 6, 2012 City Council meeting, the Council authorized an allocation of \$100,000 from the General Fund for the performance audit function. These funds shall be taken from the FY 2011-12 contingency fund and any excess funds shall carry over into FY 2012-13. Performance audits have the potential to yield dramatic savings by increasing efficiency throughout the organization.

LEGAL REVIEW:

The City Attorney's Office has reviewed and approved this report.

CONCLUSION:

The City Council expressed interest in a performance auditor function as part of last year's budget development process. The formal approval of a performance auditing process occurred on March 6, 2012. Staff is now seeking City Council approval to implement the performance audit function as soon as a qualified contractor can be secured.



RICK FRANCIS
Assistant CEO



THOMAS R. HATCH
Chief Executive Officer



BOBBY YOUNG
Finance & IT Director



THOMAS P. DUARTE
City Attorney

ATTACHMENT: 1 Weighted Risk Assessment

Weighted Risk Assessment for Proposed Engagement: [Identify Area to be Examined]

| Risk Component | Risk Description | Weighted Value A | Risk Assessment (Low=1, Med=2, High=3) B | Calculated Risk (A * B) |
|--|---|-----------------------------|---|------------------------------------|
| Financial risks | The risk that financial reporting and analyses is inaccurate, incomplete, or untimely due to a variety of factors, including errors, changes in accounting standards, or the pressure on management to meet financial obligations. | 10% | | |
| Operational risks | The risk of direct or indirect loss resulting from inadequate or failed internal processes, people, or systems, or from external events. | 10% | | |
| Criticality to City | The importance of the organizational unit to the City's ability to continue to function and carry out its primary mission. | 13% | | |
| Legal or Compliance risks | The risk of direct or indirect funding loss from failure to follow regulations and directives, including losses resulting from litigation. | 10% | | |
| Technology risks | This risk considers the level of use, sophistication, complexity, robustness, ease of use, and speed or accuracy of recovery/replacement systems or applications. | 10% | | |
| Fraud risks | The risk of loss due to intentional misappropriation of assets or intentional misstatement of financial reports. | 13% | | |
| Public/Political Sensitivity | The sensitivity of the function to public exposure of any internal issues and the level of public embarrassment that could be caused to the City as a whole. | 13% | | |
| Strategic risks | The risk that objectives will not be achieved because business strategies are poorly defined and communicated or the organization is unable to execute these strategies due to inadequate organizational structure, infrastructure, poor management decisions, or a lack of accountability. | 13% | | |
| Opportunity for Improvement/Cost Savings | The probability that addressing the issue will lead to real and timely process improvements, costs savings, or revenue enhancement | 8% | | |
| SUM TOTAL | | 100% | | |