

2/11/20


Item # 1



**Council and  
Authorities  
Concurrent Meeting**

**Item #1 – 20-1275 Discussion  
and Council Direction on  
Assigned Responsibilities of  
City Council Appointed City  
Auditor**

**February 11, 2020**



**City of  
Santa Clara**  
The Center of What's Possible

## **Agenda**

- Overview
- Assessment of the City's Environment
- Service Model Types
- Options for the Internal Audit Function

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## Overview

- The City Auditor's Office mission is to promote honest, efficient, effective and fully accountable city government through accurate, independent and objective audits.
- Our goal is to establish performance audits in the organization so we can truly know how our programs and business processes perform when comparing to other agencies.

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## Overview (cont.)

- The City Auditor is responsible for:
  - Auditing and approving all bills, invoices, payrolls, demands or charges against the City before payment (City Charter, section 909);
  - Performing financial, operational, and performance audits for the City (Ordinance 1982);
  - Managing, coordinating and monitoring audits performed under contracts;

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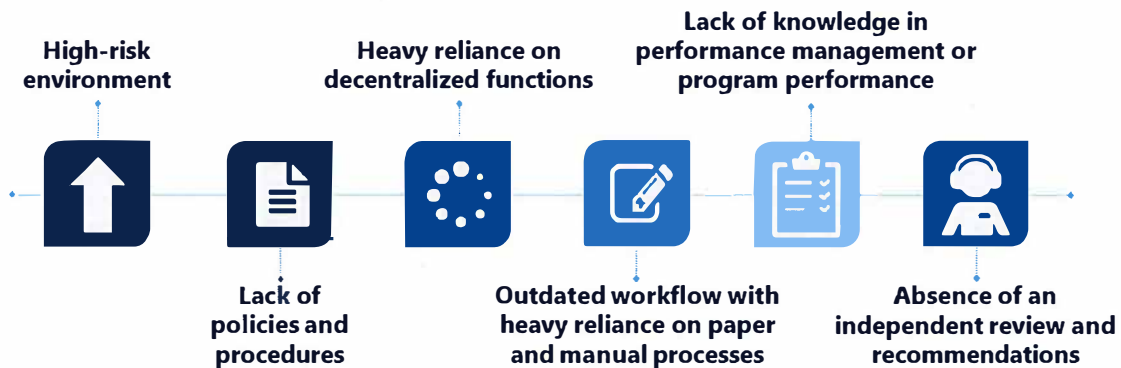
## Overview (cont.)

- Providing ad-hoc audit work or investigations for the Council and management;
- Providing audit status reports on the workplan to the Council; and
- Tracking audit recommendations and providing annual audit recommendation status updates to the Council.

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## Observations



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## Observations (cont.)

- **Is the City audit ready like other nearby agencies?**
  - Internal audit is a new concept to the City, some City functions are not completed with pre-audit processes in place.
  - Requires additional time to reintroduce the function to employees again.
    - Past practices did not enforce pre-audit policies and procedures or best practices.

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## Current State

- Completed all the audit foundation work (i.e. Internal Audit Charter, internal audit job series, an assessment of the City's environment).
- Ready to continue audit functions and advance audit workplan.

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## Service Model Types

- What delivery model is best suited for the City?
  - In-house
  - Outsource
  - Co-source
- What should our total internal audit investment be?

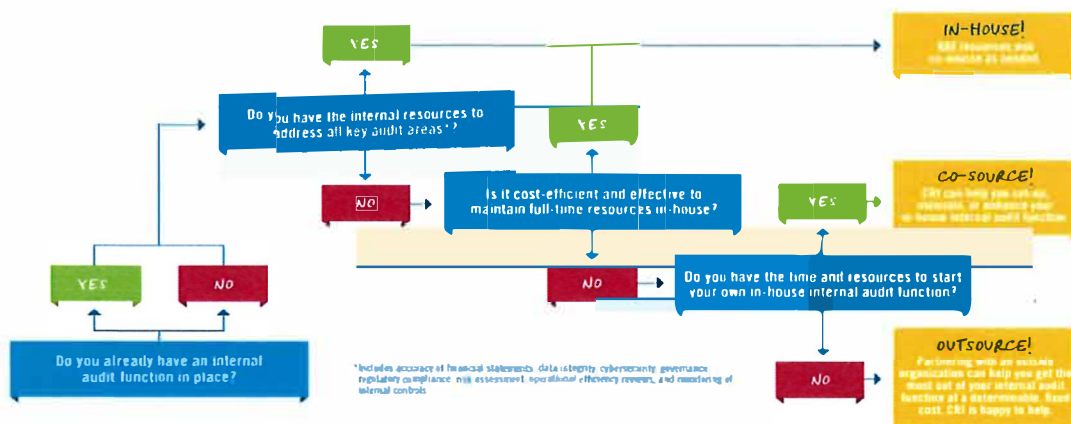
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## Service Model Types (cont.)

### In-House, Co-Source, or Outsource?

Determine how to handle your internal audit function.



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## Current Service Model

- **Hybrid Structure** - outsource and co-source all audit projects, except for some ad-hoc review projects
  - Necessary to preserve the independence required in the internal audit function due to the current reporting structure
  - Allows for city staff to be onsite to provide continuous training and re-enforcement of policies and procedures
  - Provides continuous review, oversight and report on the status of audit recommendations to the Council

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## Current Service Model (cont.)

- Co-sourcing is a model where you share audit work responsibilities with the consultant
  - Cost savings
  - Gaining expertise
  - Common practice in the private sector

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## Co-Source Example

- Master Vendor Audit

Description	Estimated Hours	Estimated Cost
Original Projections	800	\$132,000
Proposed	1,400	\$265,800
Co-source	800	\$152,000
<b>Savings with Co-source</b>		<b>\$113,800</b>

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## Rate Comparison

Cost Range	Blended Hourly Rate
Low Range	\$190
Mid Range	\$220
High Range	\$250
<b>In-house Staff (fully burdened)</b>	<b>\$170*</b>

\*Blended rate is based on two FTEs in audit

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## Pros of Service Models

Description	In-House Model	Outsource Model	Hybrid Model
Full service in-house internal audit function	X		
Onsite Internal Audit presence and subject matter expertise	X		X
Continuous review and oversight of Audit Recommendations to Council	X		X
Audits are independently managed by a City Auditor	X		X
Management focus		X	X
Gaining expertise		X	X
Cost savings		X	X

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## Cons of Service Models

Description	In-House Model	Outsource Model	Hybrid Model
Limited Expertise	X		
Long implementation period to be in conformity with professional auditing standards	X		
Fixed ongoing staff costs	X		
Lack of an in-house audit subject matter		X	
Lack of continuous review and oversight over Audit Recommendations		X	
Diminished capacity resulting in heavy reliance on the consultants		X	X
Project timeline is dependent on the consultant		X	X
Potential higher contractual spending		X	X

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## Staffing and Governance Structure

Description	In-House Model	Outsource Model	Hybrid Model
Staffing	5 FTEs in Audit + 1 FTE in operations for Charter work	1 FTE in operations for Charter work	2 FTEs in Audit + 1 FTE in operations for Charter work
Audit Work Responsibilities	City Auditor's Office	Consultant managed by the Council/Audit Committee	City Auditor's Office + Consultant
Governance Structure	City Auditor's Office report to Audit Committee & Council	<b>Consultant managed by the Council / Audit Committee</b>	City Auditor's Office report to Audit Committee & Council
Audit Recommendations Reporting & Monitoring	City Auditor's Office	To be determined by Council	City Auditor's Office

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## Regional Benchmarking

Agency Name	Annual Expenses	# of FTEs	Annual Audit Budget	# of FTEs in Audit	Average # of Audits Completed Annually
City of Palo Alto	\$508,426,000	1,059	\$1,458,175	5	3 to 4
City of Berkeley	\$387,216,873	1,532	\$1,600,000	6	5 to 6
City of Oakland	\$1,060,720,000	3,418	\$2,200,000	10	5 to 8
<b>City of Santa Clara</b>	<b>\$907,827,980</b>	<b>1,105</b>	<b>\$1,237,543</b>	<b>2</b>	<b>3 to 4</b>

(This data was provided by Kevin W. Harper CPA & Associates. The firm was hired by the City of Palo Alto to prepare the cost survey in 2019)

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## **Option 1: Maintain the Hybrid model**

- Maintain the Hybrid model
  - All audit work will be either outsourced or co-sourced
  - Reduces time and cost overruns in audit projects
  - The City Auditor will continue to identify the audit subjects, prepare the work plan, and communicate to the Council on work plan and audit recommendation status

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## **Option 2: Build An In-House Internal Audit function**

- Full service in-house internal audit function
  - Able to support the City with more Ad-Hoc audit projects
- Audit projects would be performed in-house by staff
  - The audit team would need to increase by 3 FTEs, which could increase the budget by \$721,000

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## **Option 2: Build An In-House Internal Audit function (cont.)**

- Consultant services will be limited to the annual financial statements audits.
- A revision to the current ordinance may be necessary to establish that the Council-appointed City Auditor, and his/her staff, are independent from the rest of the City staff that they audit.

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## **Option 3: Assign Certain Duties to contract employees**

- The Council could consider reducing the duties of the City Auditor to auditing and approving payments and outsource the internal audit function to consultant.
- Staff will return with a Study Session to discuss the roles, duties and qualifications of outside professional services for the internal audit function.

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## **Alternatives**

1. Direct staff to build a tradition in-house internal audit function.
2. Direct staff to outsource the internal audit function and return to Council with a Study Session on the function.
3. Take no action – maintain the Hybrid model.
4. Any other action as determined by the Council.

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