



CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

August 5, 2013

The Honorable City Council
Palo Alto, California

Special Advisory Memorandum - Follow Up to the 2008 Audit of Employee Ethics Policies and the Results of 2013 Ethical Climate Survey

This is an informational report and no action is required.

The Office of the City Auditor has prepared the attached Special Advisory Memorandum (SAM) for your review and consideration.

The purpose of this SAM is to inform the City Council of the non-audit service we provided to the City Manager's Office. The objective is to update the City Council regarding our follow-up activities relating to the 2008 Audit of Employee Ethics Policies.

Additionally, as Audit Standards require my office to periodically evaluate the ethical climate of the organization, this memo is also used to communicate the results of an Ethical Climate Survey conducted by my office in May 2013. The objective of this survey was to understand how City employees view ethics at work and identify any ethics related risks that may need to be addressed.

I would like to thank the City Manager's Office for their time, consideration, and cooperation in the development of this SAM. Should you have any questions, please contact my office at your convenience.

Respectfully Submitted,

Jim Pelletier
City Auditor

ATTACHMENTS:

- Attachment A: Special Advisory Memorandum - Follow Up to the 2008 Audit of Employee Ethics Policies and Results of 2013 Ethical Climate Survey (PDF)

Department Head: Jim Pelletier, City Auditor



Office of the City Auditor SPECIAL ADVISORY MEMORANDUM

Follow Up to the 2008 Audit of Employee Ethics Policies and the Results of 2013 Ethical Climate Survey

The Honorable City Council
Palo Alto, California

The purpose of this special advisory memo is to update the City Council regarding our follow-up activities relating to the 2008 Audit of Employee Ethics Policies. Additionally, as Audit Standards require my office to periodically evaluate the ethical climate of the organization, this memo will also be used to communicate the results of an Ethical Climate Survey conducted by my office in May 2013. The objective of this survey was to understand how City employees view ethics at work and identify any ethics related risks that may need to be addressed. We caution drawing any broad conclusions based on the results of the survey. The survey should serve as a baseline for ongoing ethics efforts within the City and should be compared to future results to illustrate whether these efforts are having the desired impact.

BACKGROUND

City Auditor's Role

The Palo Alto Municipal Code requires that the City Auditor conduct audits in accordance with the Government Auditing Standards (GAS) established by the United States Government Accountability Office and International Standards for the Professional Practice of Internal Auditing established by the Institute of Internal Auditors (IIA Standards). The GAS set forth fundamental ethical principles that should be applied in conducting audit work and IIA Standards require that the internal audit activity periodically evaluate the design, implementation, and effectiveness of the organization's ethics-related objectives, programs, and activities.

About SAMs

The Office of the City Auditor issues Special Advisory Memos (SAMs) to provide important information to the City Council and City Management in a quick and flexible manner. SAMs are prepared in coordination with relevant City Departments and are utilized for timely communication of limited reviews or evaluations.

City Auditor

Jim Pelletier, CIA

Senior Performance Auditor

Yuki Matsuura, CPA, CCSA, CRMA

Audit of Employee Ethics Policies

In January 2008, the Office of the City Auditor issued the Audit of Employee Ethics Policies which provided seven recommendations to improve the City's ethics program as summarized in the following table:

Status of Audit Recommendations as of 6/30/13

| Recommendation | Current Status |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------|
| 1. Periodically provide ethics training targeted for designated employees. | Completed |
| 2. Department heads and supervisors of employees in designated positions should review, and initial, employee Form 700s. | Completed |
| 3. Develop a section on the City's intranet site that links City employees to the City or State policy, procedure, law, or regulation that addresses each of the major requirements for avoiding conflicts of interest and for ethical behavior. | Completed* |
| 4. Develop a code of ethics and require employees to read and sign an acknowledgment of the policy. | In Process |
| 5. Formalize City policy on ethics training and ensure that employees attend periodic training updates. | In Process |
| 6. Survey employees using the League of California Cities' Institute for Local Government's ethical culture assessment tool. | Completed |
| 7. Form a working group to (1) establish policies and procedures for handling employee complaints of waste, fraud, and abuse; (2) establish and monitor an anonymous hotline; (3) develop procedures for reporting, investigating, handling, and following-up on hotline reports; and (4) develop whistleblower policies and procedures. | Completed |

* There was no such link available on the City's new intranet site at the time this memo was issued. The City Manager's Office reports that it will be added by September 1, 2013.

Two of the seven audit recommendations remain to be completed by the City Manager's Office. To evaluate the design, implementation, and effectiveness of the City's ethics-related objectives, programs, and activities, we conducted an Ethical Climate Survey.



Office of the City Auditor SPECIAL ADVISORY MEMORANDUM

Ethical Climate Survey

The Ethical Climate Survey tool was developed by the Institute for Local Government (ILG) and International City/County Management Association to assist local government agencies in understanding the degree to which ethical standards influence decision-making by both the agency and individuals within the agency. The assessment is designed to provide either “reassurance that the agency’s ethical house is in order or an indication of potential ethical blind spots that, if left un-addressed, could lead to embarrassment or worse down the road”.

SCOPE & METHODOLOGY

We used the ILG’s Ethical Climate Survey tool which consists of 20 indicators (10 for the Employee section and 10 for the Management section). For the Employee section, each statement starts with “In my local government, I am...” and each indicator completes the statement. For the Management section, each statement starts with “The executives in my local government...” completed by each indicator. For each statement, respondents were asked whether it is “Always,” “Almost Always,” “Sometimes,” or “Rarely” the case that best describes their experiences and perceptions working for the City. They were asked to select “Don’t know” if they don’t know well enough to answer.

The survey was anonymous and sent to all City employees (1,137) on May 29, 2013. The survey was closed on June 6, 2013. Participation was voluntary and employees were asked to identify their position as Management (Assistant Director and above), Supervisory (if you supervise one or more City employees, interns, or volunteers), or Staff. A total of 324 employees participated in the survey, a response rate of 28%. All 324 survey participants completed the Employee section, 311 completed the Management section, and 302 identified their position.

Employee Participation by Position

| Participants | # | % |
|--------------|------------|-------------|
| Management | 23 | 8% |
| Supervisory | 74 | 25% |
| Staff | 205 | 68% |
| Total | 302 | 100% |

The City’s Ethical Climate Score was determined using the ILG’s Scoring Matrix included at the end of this memo. The average score for each question is reported on the 10-point scale where 10 is the best possible rating. Each response option was converted to points using the scale values assigned as follows:

Scale Values by Response Option

| Always | Almost Always | Sometimes | Rarely |
|-----------|---------------|-----------|------------|
| 10 points | 7.5 points | 5 points | 2.5 points |

The total score was then determined by adding the average scores within each section and for the entire survey. The “Don’t Know” responses have been removed from the analyses. The tables and graphs display the responses from respondents who had an opinion about a specific item.

We reviewed the results including comments provided by the survey participants to identify any ethics related risks and control gaps that may need to be addressed.

We obtained feedback from the City Manager’s Office and the People Strategy and Operations Department regarding overall results and opportunities for improvement. Individual responses were kept confidential and were not made available to management.

This was a limited scope review not conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS). A majority of the information presented in this memo is based on staff representations that were not independently validated. It is management’s responsibility to evaluate the adequacy and results of the services performed and to design, implement, and maintain internal controls.



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Office of the City Auditor SPECIAL ADVISORY MEMORANDUM

SURVEY RESULTS

The overall score of the City's first Ethical Climate Survey was medium. Based on the ILG Scoring Matrix, this means that the City's overall ethical climate is at a good place but has room to improve by:

1. Evaluating the areas of weakness indicated by the questionnaire and considering targeted remedial actions.
2. Analyzing the messages that staff and others receive and send about ethics.
3. Reviewing the agency's policies, including the criteria by which staff are evaluated.
4. Considering whether having a code of ethics would be helpful for the agency.

The table below shows a summary of the survey results. Additional tables and charts for each section of the survey are also included at the end of this memo.

Survey Results Summary

| Section | Results | Mgmt | Supv | Staff | Overall |
|-------------------------|---------|------|--------|--------|---------|
| Employee Section | Score | 87 | 78 | 74 | 75 |
| | Rating | High | High | Medium | High |
| Mgmt Section | Score | 80 | 72 | 70 | 71 |
| | Rating | High | Medium | Medium | Medium |
| Total | Score | 167 | 150 | 144 | 146 |
| | Rating | High | High | Medium | Medium |

Of 324 survey participants, 71 provided comments regarding the City's ethical climate. Comments that appeared similar in nature and intent are summarized below:

- Some senior management and supervisors do not always follow City policies and/or are not always good role models for staff (16)
- The City's ethical climate is good and/or has improved in recent years (13)
- Unaware of or uncomfortable with ways to report ethical issues anonymously (5)
- Afraid of retaliation (have been or know someone who has been retaliated against) (4)
- Unaware of or curious as to why the City does not have Citywide ethics policies (4)

- Promotion appears to be based on relationship rather than performance (3)

ADDITIONAL CONTEXT/2007 NATIONAL SURVEY

The Ethics Resource Center (ERC) conducted the National Government Ethics Survey in 2007 and reported the following findings, among others, for all local governments:

- Many local government employees see misconduct at work. 63% of local government employees observed at least one type of misconduct in the past twelve months. This rate is higher than all other kinds of government and both publicly-traded and privately-held businesses (57% and 55%, respectively).
- Top management in local governments is likely to be unaware of the problem. One-third of local government employees who observed misconduct did not report it. Only 3% report misconduct using whistleblower hotlines. Instead, local government employees prefer reporting to a supervisor or an individual in higher management. Unless top management trains supervisors to recognize, address, and document reports, allegations may not be handled properly and measures may not be taken to prevent future incidents.
- Many local government employees who reported misconduct experienced retaliation. One out of five local government employees who reported misconduct experienced retaliation as a result; this is the highest rate among all levels of government.

The Ethics Resource Center is not the only organization that promotes **Effective Ethics and Compliance Programs**. **Federal Sentencing Guidelines for Organizations** provide strong incentives (i.e. reduced punishment) for organizations that exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program. **The Association of Certified Fraud Examiners' 2012 Report to the Nations** also highlights the importance of a proper ethical tone from management in protecting an organization against the largest frauds.



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Office of the City Auditor SPECIAL ADVISORY MEMORANDUM

- The majority of local government employees do not know that their workplace provides comprehensive ethics & compliance program resources to offer guidance and help. This highlights the need for more robust and effective ethics resources at the local level.

The ERC identifies the following four components of a strong enterprise-wide cultural approach to government ethics:

1. **Ethical leadership:** tone at the top and belief that leaders can be trusted to do the right thing.
2. **Supervisor reinforcement:** individuals directly above the employee in the organization's hierarchy set a good example and encourage ethical behavior.
3. **Peer commitment to ethics:** ethical actions of peers support employees who "do the right thing."
4. **Embedded ethical values:** values promoted through informal communications channels are complementary and consistent with a government's official values.

The ERC concluded that a strong agency-wide ethical culture together with a well-implemented ethics and compliance program leads to the greatest reduction in ethics risk, citing the following survey findings:

- Well-implemented ethics and compliance programs double reporting and reduce observations of misconduct by a quarter.
- A strong ethical culture cuts the rate of misconduct in half and significantly increases reporting.
- The largest reduction of the risk of loss of public trust comes from a combination of a well-implemented ethics and compliance program and an agency-wide commitment to a strong ethical culture.

RECOMMENDED ACTIONS

We recommend that the City Manager's Office make it a priority to complete the remaining audit recommendations:

- Recommendation #4: The City should develop a code of ethics that employees can use as guidance for avoiding conflicts of interest, for encouraging ethical behavior, for deciding what actions are needed when conflicts of interest occur, and for making ethical decisions. Employees should be required to read and sign an acknowledgment of the policy.
- Recommendation #5: The City should formalize its policy on ethics training and ensure that employees attend periodic training.

In addition to policies and procedures, a well-implemented program should include:

- Establishing ethics as a priority for leadership at all levels within the organization
- Clear communication of the process for reporting and handling incidences of misconduct and for protecting whistleblowers.
- Establishing accountability measures to ensure that the formal program efforts and internal controls are yielding intended outcomes. Conducting this Ethical Climate Survey was our attempt to assist management in this regard and we intend to conduct the survey on an annual basis to provide outcome measures in ethical culture over time.

NEXT STEPS

No response to this memo is required. We will incorporate the survey results in our annual risk assessment and plan to conduct this survey annually to assess the City's ethical culture over time. We will also perform a limited review of the recommended actions during our annual follow-up of the recommendations for the Audit of Employee Ethics Policies.

Respectfully submitted,

Jim Pelletier
City Auditor




cc: Executive Leadership Team

Institute for Local Government Ethical Climate Survey Scoring Matrix

Scale Values by Response Option

| Always | Almost Always | Sometimes | Rarely |
|-----------|---------------|-----------|------------|
| 10 points | 7.5 points | 5 points | 2.5 points |

Your Local Government's Ethical Climate

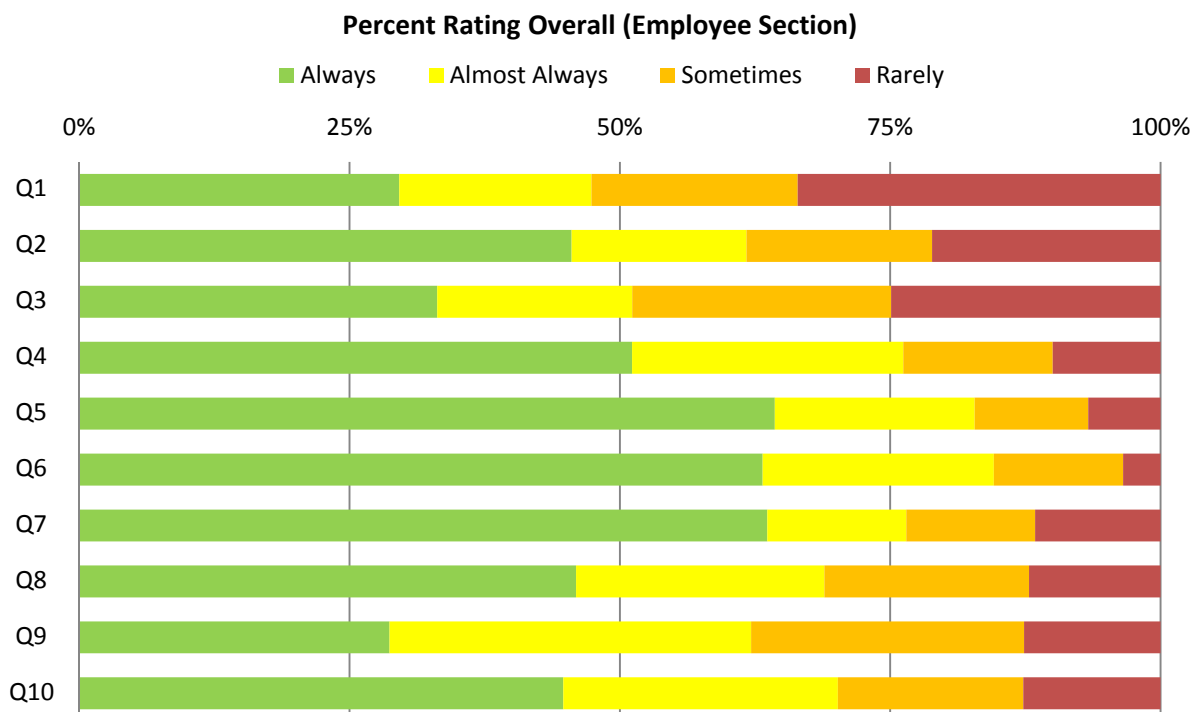
| Score | Rating | What it Means/Steps to Take |
|---------------------------------------|---------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 75-100 per section 150-200 overall | High  | <p>Congratulations! Your agency has a strong ethical environment. Keep up the good work, including such steps as:</p> <ul style="list-style-type: none"> <input type="checkbox"/> Incorporating ethics into the hiring and evaluation process for staff <input type="checkbox"/> Conducting regular ethics-related learning opportunities, including examples of ethical dilemmas and ways to resolve them <input type="checkbox"/> Going through specific items on the assessment to identify further opportunities for positive change <input type="checkbox"/> Reinforcing the importance of ethical considerations in agency behaviors and decisions |
| 50-74 per section 100-149 overall | Medium  | <p>Take a moment to reflect. Your agency is at a good place but has room to improve by doing the following:</p> <ul style="list-style-type: none"> <input type="checkbox"/> Evaluating the areas of weakness indicated by the questionnaire and considering targeted remedial actions <input type="checkbox"/> Analyzing the messages that staff and others receive and send about ethics <input type="checkbox"/> Reviewing the agency's policies, including the criteria by which staff are evaluated <input type="checkbox"/> Considering whether having a code of ethics would be helpful for the agency <input type="checkbox"/> Following the best practices indicated in the box above. |
| 0-49 per section 0-99 overall | Low  | <p>Stop! Your agency's culture needs significant change. Suggested activities include:</p> <ul style="list-style-type: none"> <input type="checkbox"/> Identifying the aspects of the agency's culture that foster the problematic behaviors and analyze how to remediate them <input type="checkbox"/> Consulting with your agency's attorney about potential violations of laws and agency regulations <input type="checkbox"/> Following the best practices indicated in the boxes above |

Source: Institute for Local Government: Assessing Your Agency's Ethical Culture

Survey Results

Employee Section – Ethical Climate in the Workplace

| In my local government, I am... | Average Score |
|-------------------------------------------------------------------------------------------------------------------------------------|---------------|
| Q1. Encouraged to speak up about any agency practices and policies that are ethically questionable. | 6.1 |
| Q2. Expected to report questionable ethical behaviors of others. | 7.2 |
| Q3. Clear about where to turn to for advice about ethical issues. | 6.5 |
| Q4. Expected to follow the spirit as well as letter of the law in my work for the agency. | 7.9 |
| Q5. Expected to use ethical behaviors in getting results. | 8.5 |
| Q6. Expected to tell the complete truth in my work for the agency. | 8.6 |
| Q7. Expected to treat everyone who comes before the agency equally, regardless of personal or political connections. | 8.2 |
| Q8. Expected to follow stated policy of the governing body and not the desires of individual elected or appointed officials. | 7.6 |
| Q9. Surrounded by coworkers who know the difference between ethical and unethical behaviors, and seem to care about the difference. | 7.0 |
| Q10. Working with one or more trusted confidantes with whom I can discuss ethical dilemmas at work. | 7.6 |
| Employee Section Total | 75.1 |

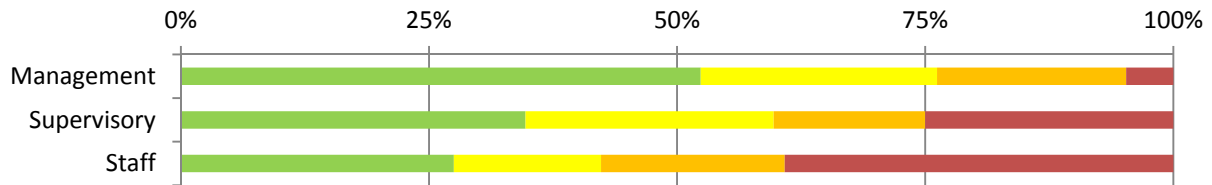


Employee Section – Ethical Climate in the Workplace

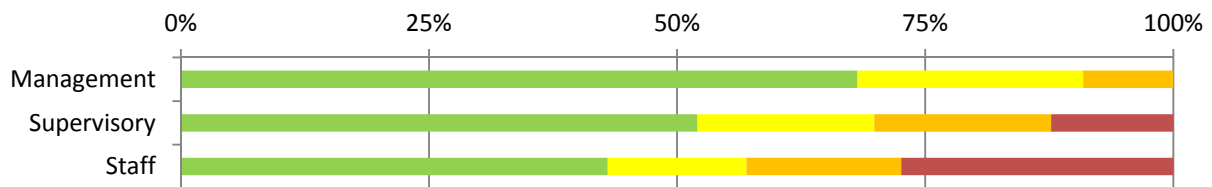
In my local government, I am...

Always Almost Always Sometimes Rarely

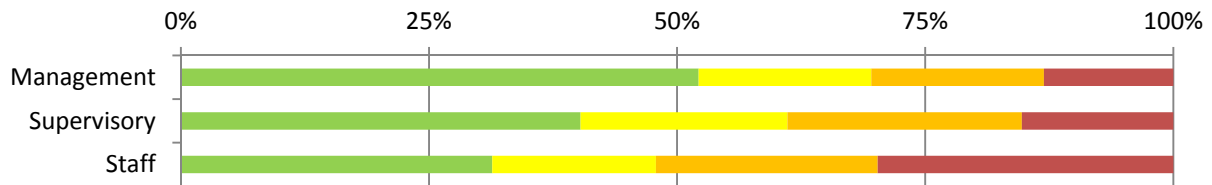
Q1. Encouraged to speak up about any City practices and policies that are ethically questionable.



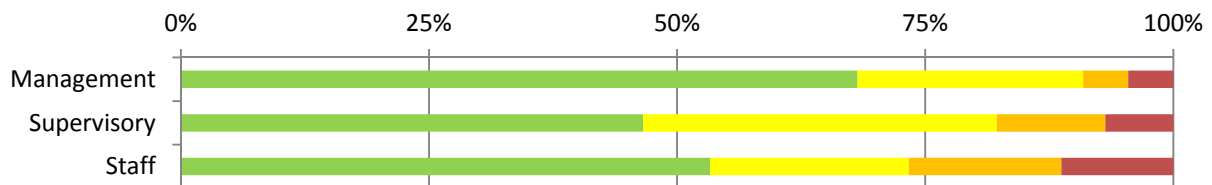
Q2. Expected to report questionable ethical behaviors of others.



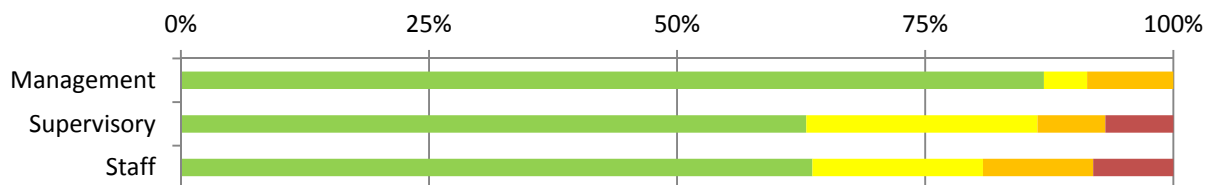
Q3. Clear about where to turn for advice about ethical issues.



Q4. Expected to follow the spirit as well as the letter of the law in my work for the City.



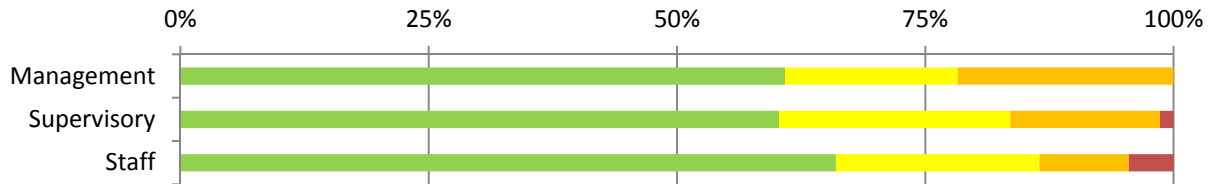
Q5. Expected to use ethical behaviors in getting results.



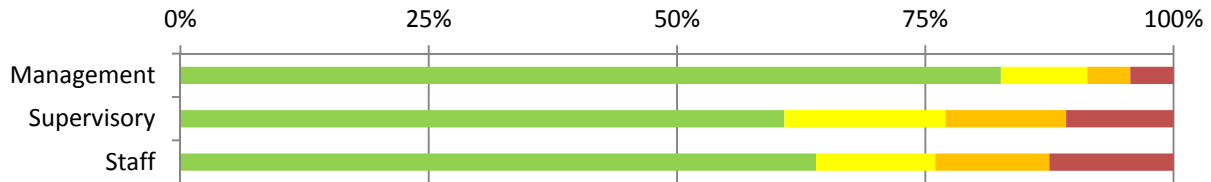
Employee Section – Ethical Climate in the Workplace

In my local government, I am... ■ Always ■ Almost Always ■ Sometimes ■ Rarely

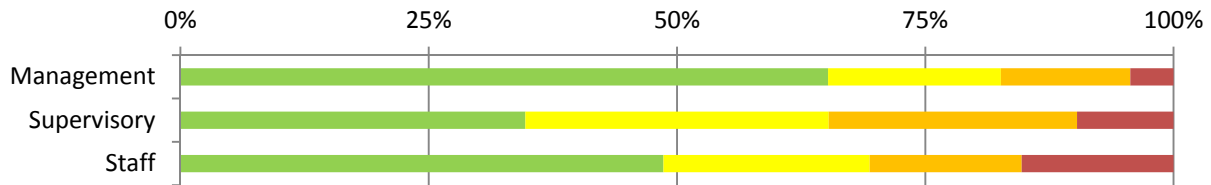
Q6. Expected to tell the complete truth in my work for the City.



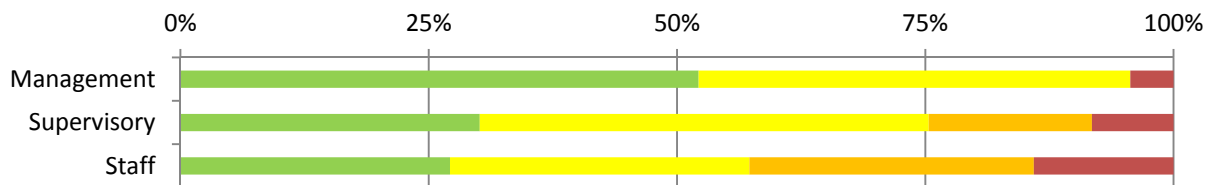
Q7. Expected to treat everyone who comes before the City equally, regardless of personal or political connections.



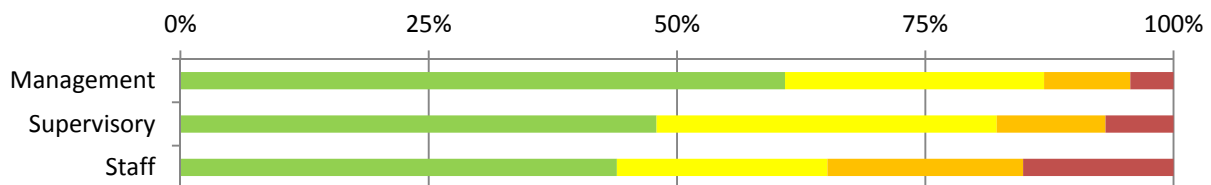
Q8. Expected to follow stated policy of the governing body and not the desires of individual elected or appointed officials.



Q9. Surrounded by co-workers who know the difference between ethical and unethical behaviors and seem to care about the difference.



Q10. Working with one or more trusted confidantes with whom I can discuss ethical dilemmas at work.

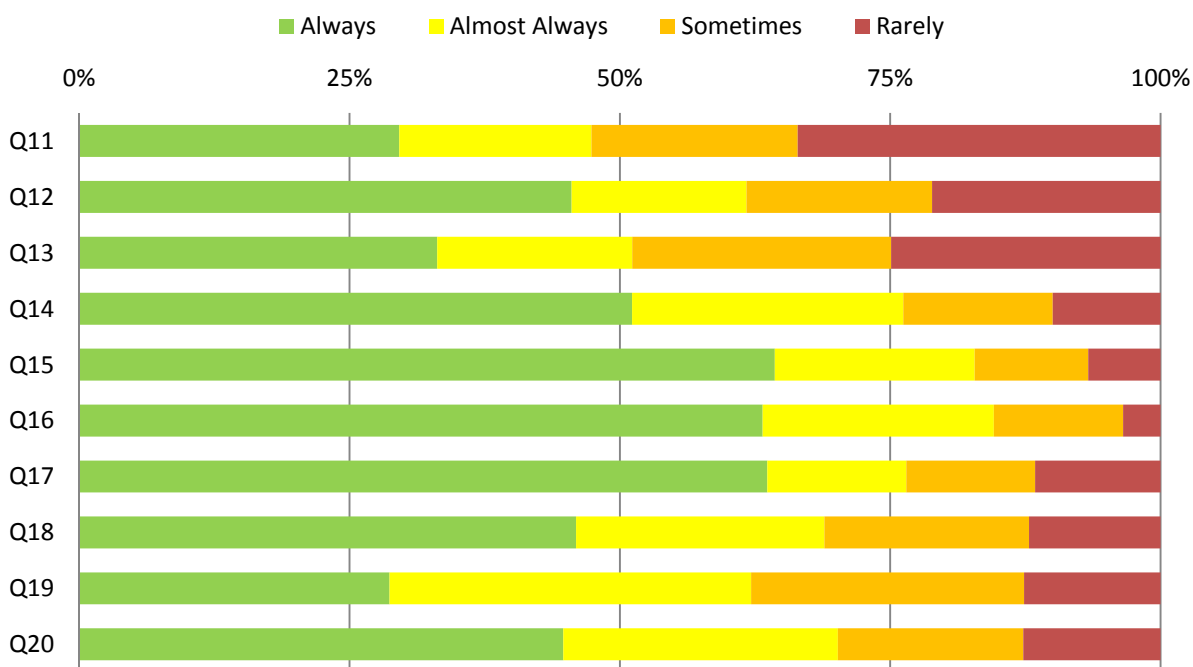


Survey Results

Management Section – Ethical Climate Tone at the Tops

| The executives in my local government... | Average Score |
|----------------------------------------------------------------------------------------------------------------------------------------------------------|---------------|
| Q11. Create an environment in which staff is comfortable raising ethical concerns. | 6.1 |
| Q12. Appreciate staff bringing forward bad news and don't "shoot the messenger" for doing so. | 6.1 |
| Q13. Expect staff to use ethical practices in getting results – not "whatever it takes." | 7.1 |
| Q14. Gear their decisions to the spirit as well as letter of the law. | 6.8 |
| Q15. Treat the public with civility and respect. | 8.7 |
| Q16. Use public resources only for agency purposes and not for their own personal or political uses (such as agency supplies, staff time and equipment). | 8.2 |
| Q17. Appoint and reward people on the basis of performance and contribution to the organization's goals and services. | 5.6 |
| Q18. Treat all members of the public equally, regardless of who has people "connections." | 6.7 |
| Q19. Help elected officials work within their policy role and stay out of day-to-day work of the agency. | 6.6 |
| Q20. Refuse to accept gifts and/or special treatment from those with business before the agency. | 8.7 |
| Management Section Total | 70.7 |

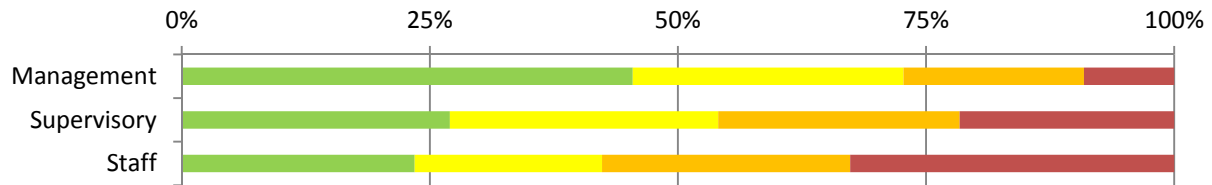
Percent Rating Overall (Management Section)



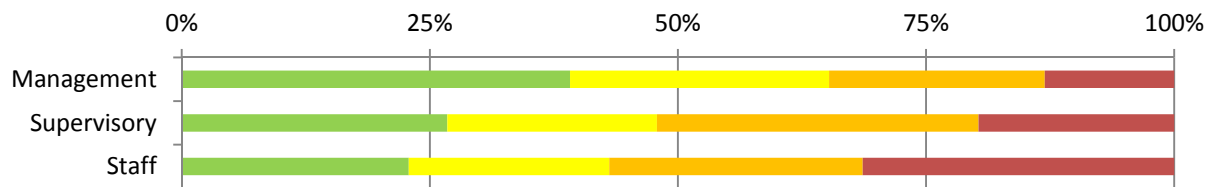
Management Section – Ethical Climate Tone at the Tops

The executives in my local government... ■ Always ■ Almost Always ■ Sometimes ■ Rarely

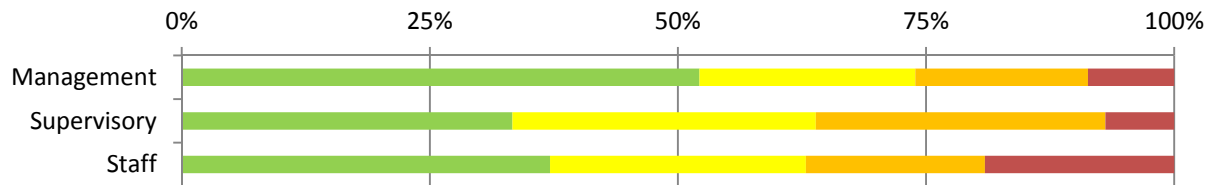
Q11. Create an environment in which staff is comfortable raising ethical concerns.



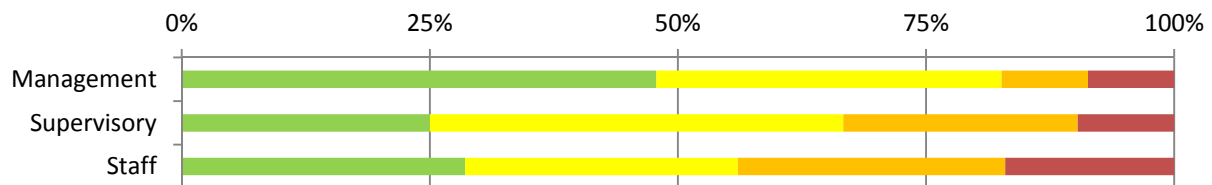
Q12. Appreciate staff bringing forward bad news and don't "shoot the messenger" for doing so.



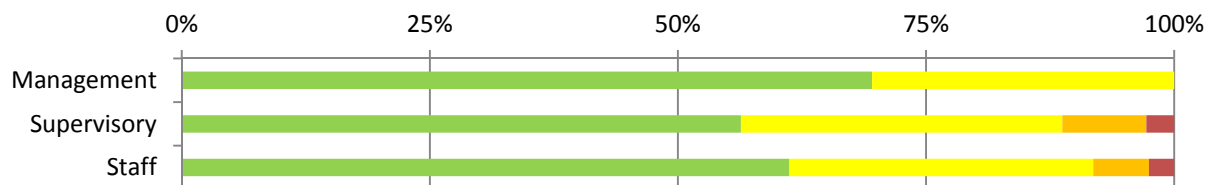
Q13. Expect staff to use ethical practices in getting results – NOT "whatever it takes."



Q14. Gear their decisions to the spirit as well as letter of the law.



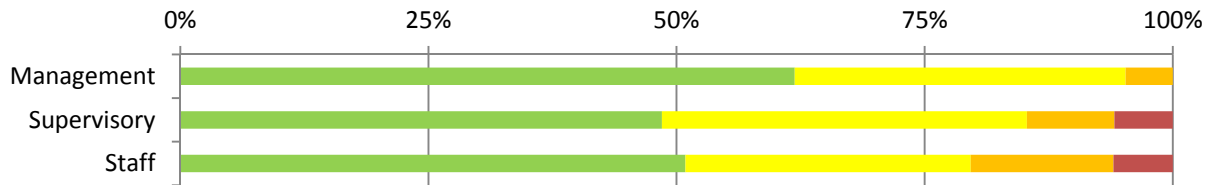
Q15. Treat the public with civility and respect.



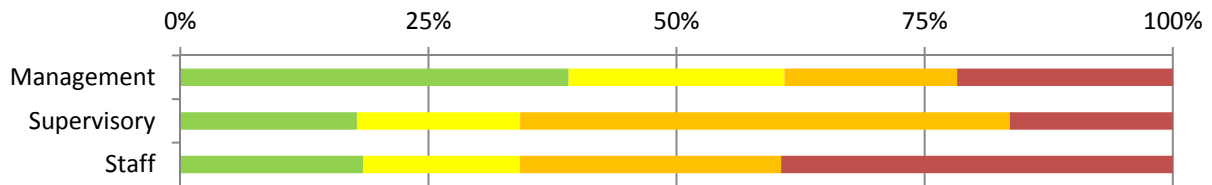
Management Section – Ethical Climate Tone at the Tops

The executives in my local government... ■ Always ■ Almost Always ■ Sometimes ■ Rarely

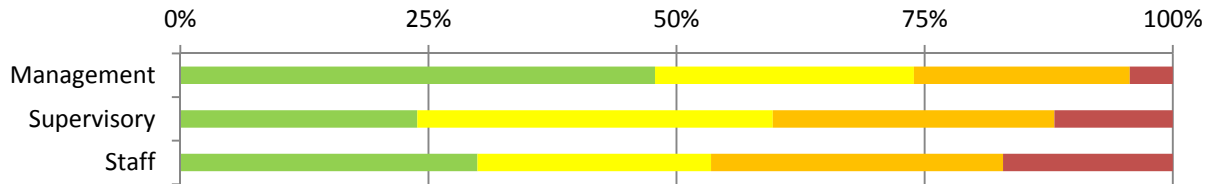
Q16. Use public resources only for City purposes and not for their own personal or political uses.



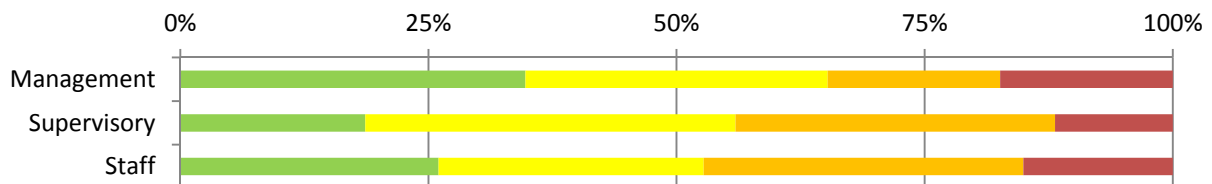
Q17. Appoint and reward people on the basis of performance and contribution to the City's goals and services.



Q18. Treat all member of the public equally, regardless of who has people "connections."



Q19. Help elected officials work within their policy role and stay out of day-to-day work of the City.



Q20. Refuse to accept gifts and/or special treatment from those with business before the City.

