



CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

October 21, 2013

The Honorable City Council
Palo Alto, California

Policy and Services Recommendation to Accept the City Auditor's Office Fiscal Year 2014 Proposed Work Plan and Risk Assessment

At its meeting on September 10, 2013, the Policy and Services Committee unanimously recommended the City Council accept the City Auditor's Office Fiscal Year 2014 Proposed Work Plan and Risk Assessment. The Auditor's Office will be issuing quarterly reports describing the status and progress of the work plan.

Respectfully submitted,

Houman Boussina
Acting City Auditor

ATTACHMENTS:

- Attachment A: City Auditor's Office Fiscal Year 2014 Proposed Work Plan and Risk Assessment (PDF)
- Attachment B: Policy and Services Committee Meeting Minutes Excerpt (September 10, 2013) (PDF)

Department Head: Houman Boussina, Acting City Auditor



CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

September 10, 2013

The Honorable City Council
Attention: Policy & Services Committee
Palo Alto, California

City Auditor's Office Fiscal Year 2014 Proposed Workplan and Risk Assessment

RECOMMENDATION

The Office of the City Auditor (OCA) recommends that the Policy & Services Committee review and recommend to the City Council approval of the OCA's Fiscal Year (FY) 2014 Citywide Risk Assessment and Work Plan.

BACKGROUND

The mission of the Auditor's Office is to promote honest, efficient, effective and fully accountable City government. To fulfill this mission, the Auditor's Office conducts audits of City departments, programs, and services. The purpose of these audits is to provide the City Council and City management with information and evaluations regarding the effectiveness and efficiency with which City resources are employed, the adequacy of systems of internal controls, and compliance with City policies and procedures and regulatory requirements.

The Palo Alto Municipal Code requires the City Auditor to submit an annual Work Plan to the City Council for review and approval. The Work Plan is based upon a Citywide Risk Assessment that is conducted annually with the cooperation of City management. The attached report presents an overview and the results of the Citywide Risk Assessment and the proposed Work Plan for FY 2014.

NEXT STEPS

As audit work proceeds, we will issue quarterly reports summarizing the status and progress of each of the approved assignments. The quarterly reports will be issued to the City Council and discussed with the Policy & Services or Finance Committee as defined in the Work Plan.

Respectfully submitted,

Jim Pelletier, CIA
City Auditor

ATTACHMENTS:

- Attachment A: Annual Citywide Risk Assessment & Work Plan FY 2014 (PDF)

Department Head: Jim Pelletier, City Auditor



CITY OF
**PALO
ALTO**

Annual Citywide Risk Assessment & Work Plan

Fiscal Year 2014



Office of the City Auditor

"Promoting honest, efficient, effective, and fully accountable city government."

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About Risk Assessment

Risk Assessment Defined

Risk is present in every aspect of government. From financial reporting and investing to community services and public safety, risk is present in the delivery of all services provided and all activities performed by the City. The annual risk assessment performed by the Office of the City Auditor (OCA) is the process of identifying and analyzing inherent risks to the achievement of the City's objectives. Risk is defined as the potential event or missed opportunity that may negatively impact the City's ability to meet its objectives. Inherent risk represents the risks to the organization in the absence of any actions management might take to reduce or otherwise manage identified risks.

In general, there are two key factors in assessing risk:

- **Likelihood** represents the probability that a risk can occur. In determining likelihood, we consider the source of the threat or opportunity, the capability of that source, and the nature of the possible vulnerability in the City.
- **Impact** represents the potential effect that a risk could have on the City if it occurs. Impact can be present in many forms including financial, operational, compliance, and reputational, among others.

Managing Risk

The City Council and City management should continually assess risks facing the City and take the appropriate actions (risk response) to address those risks. Possible risk responses include:

- **Reduction** of the risk by taking actions to reduce the likelihood and/or impact of the risk. This is the most common risk response and involves the implementation of controls.
- **Sharing** of the risk by transferring all or a portion of the risk to another entity. Examples include purchasing insurance or outsourcing certain activities (outsourcing does not relieve the City's responsibility to manage the risk; it simply brings additional expertise to assist in controlling it).
- **Acceptance** of the risk which means that no action is taken and management is willing to deal with the risk as is rather than spending valuable resources.
- **Avoidance** of the risk by not participating in the process that initially generated the risk. This is often not an option for the City as many of the activities performed are required.

Risk - the potential event or missed opportunity that may negatively impact the City's ability to meet its objectives.

Audit Plan Development

Overview

The OCA uses a risk-based approach to audit planning based on utilizing a recognized best practice framework.¹ Within this framework, our work focuses on three key areas: operations (efficient and effective use of resources), reliability of reporting, and compliance with applicable laws and regulations.

This risk-based approach, illustrated in Figure 1, is a means to help identify and prioritize potential audits based on the level of risk to the City with the following benefits:

- Prioritizes high-risk areas within the City for audits in upcoming fiscal years.
- Ensures that the OCA’s resources are effectively and efficiently focused on where they are most needed in alignment with the City Council’s priorities and the City’s goals and objectives.
- Eliminates unnecessary audits that may be duplicative or audits that may not address higher risk areas of the City.

Figure 1



Environmental Scan

Throughout the year, the OCA collects information that provides important input into the audit plan development process. Additionally, the OCA solicits input from multiple sources including the City Council, City management, the City’s external auditor, audit departments in peer cities and other local jurisdictions, as well as regional/national audit resources including the United States Government Accountability Office, the Association of Local Government Auditors, and the Institute of Internal Auditors. See the Summary of Environmental Scan Considerations below for more information.

Table 1 - Summary of Environmental Scan Considerations

Environmental Scan Consideration	Description
Expectations from External Parties	Consideration of citizen survey results, current events, & broad economic conditions. Input from the City’s external auditor and from Statewide audit entities.
Benchmarking	Input from city peer groups including surveys of other audit departments and research of current audit trends from regional and national resources.

¹ The Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control – Integrated Framework.

Expectations from inside the City	Input from City Council, City management/staff, and OCA staff.
Past Audit Experience	Review of past audits and audit recommendations. Consideration of gaps in audit coverage and the length of time since last audit.
Current Risk Environment	Economic conditions impacting City operations, current information Technology environment, and considerations of disaster recovery and business continuity.
Risk Environment Forecast	Budgetary pressures, economic outlook, and State/Federal agendas.

Audit Prioritization Categories

To facilitate the identification of potential audits, the OCA developed a set of Audit Prioritization Categories tied to the Council Priorities and the broader overall strategy of the City. The categories are described below:

Audit Prioritization Categories	Description
Design, Transportation, and Livability	Programs and services that impact the quality of development and design within the City, broaden the City's tax and revenue base, preserve and enhance key environmental attributes, minimize energy and water use, and promote transportation alternatives such as walking, bicycling, and transit. Examples include Development Center service and accountability, code enforcement, and parking funds.
Essential Infrastructure	Responsible stewardship of public assets through the maintenance and renewal of the City's infrastructure including the City's approach to maintaining the physical assets, modernizing and replacing aging facilities, and maximizing the public's return on investment. Examples include the Infrastructure Report Card, capital planning and budgeting, maintenance of roads, sidewalks, and city facilities. Also includes the health and safety of residents and city employees relative to infrastructure.
Technology and the Connected City	Information technology governance and systems that serve a critical role in supporting vital services within the City and to the community. Examples include logical security, backup and restoration, change management, data integrity, and segregation of duties.
Fiscal Stability	Sound management practices to protect taxpayers' dollars and ensure fiscal stability through economic fluctuations, changing priorities, and increasing demands for services. Examples include budgeting, financial planning and forecasting, and cost of services.
Environmental Sustainability	Identifying opportunities where environmental sustainability concepts can be applied to audits across the organization. Examples include sustainable purchasing practices and efficient use of resources.
Safe Community	Public safety including the Police Department, Fire Department, Office of Emergency Services, and other programs and services that affect community health and safety.
Community Impact and Quality of Life	Programs and departments directly affecting the community and the quality of life in Palo Alto. Examples include fee structures, social services, neighborhood and community programs, library programs, economic growth and development, and public works.

Support Services	Services provided internal to the City in support of other City departments. Examples include facilities, human resources, administrative services, City Clerk, City Attorney, and communications.
Contracts and Grants Monitoring	Management and monitoring of contracts and grants throughout the City. Examples include professional services contracts, general services contracts, public works contracts, and federal and state grants.
Economic Initiatives	Reducing expenditures and/or maximizing revenues. Examples include sales tax, transient occupancy tax, fees, and licenses.
Fraud, Waste, and Abuse	Administration of the City's Fraud, Waste, and Abuse Hotline as well as other activities or issues related to the misuse of City resources. Also includes efforts to promote a culture of ethics, transparency, and accountability across the organization.

Using the Audit Prioritization Categories as a guide, as well as all of the information gathered through the Environmental Scan, we developed an Audit Horizon, a master list of possible audits that can be performed. The Audit Horizon is a living document that will be regularly updated and used as the source for selecting audits for the Annual Plan.

Annual Work Plan Components

The development of the plan is a dynamic, continuous process. The risk assessment process drives the plan, but there are other components including: the Service Efforts & Accomplishments report and the Citizen Centric Report; administration of the Fraud, Waste, and Abuse Hotline; Special Advisory Memorandums; Council & management requests; and monitoring and administrative assignments. Each of these components requires OCA resources that are considered in the plan.

Audits

We select audits from the risk assessment process described above. The risk assessment guides the prioritization of the audits selected given limited resources.

Service Efforts & Accomplishments (SEA) and Citizen Centric Reporting (CCR)

The OCA prepares the annual SEA Report as well as the annual CCR. These reports are designed to provide the residents of Palo Alto, the City Council, and City staff with important data and information regarding the performance of the City. The reports are unique in that they are compilations of vast amounts of data obtained from both inside and outside the City and are prepared in coordination with all City departments. Additionally, the SEA includes the results of the annual National Citizen Survey™ which provides insight into residents' perceptions of the City's performance and allows the City to compare itself to other jurisdictions.

Administration of the Fraud, Waste, and Abuse Hotline

The OCA is responsible for administering the City's employee only Fraud, Waste, and Abuse Hotline, which is currently in a trial phase. Incident routing and monitoring is administered by the OCA and the City Auditor is a member of the Hotline Review Committee with the City Manager and the City Attorney. Additionally, certain incidents may require investigation by OCA staff.

Special Advisory Memorandums (SAMs)

SAMs 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 assessments, reviews, or evaluations.

Council & Management Requests

The plan accommodates special requests from City management and the City Council throughout the year. Larger requests may require changes to the plan.

Monitoring & Administrative Assignments

The OCA performs certain monitoring and administrative assignments including:

- Comprehensive Annual Financial Report (CAFR) and Single Audit Report – the OCA contracts with an external accounting firm to perform both the annual CAFR and Single Audit Report for the City.
- Sales and Use Tax Monitoring - the OCA monitors sales and use tax payments due to the City both through our own analysis and through partnering with a third party specialist. Claims are submitted to the State Board of Equalization to redirect misallocated tax proceeds to the City.
- Quarterly Status Reports – the OCA prepares quarterly status reports for the City Council.
- Annual Open Audit Recommendation Follow Up – as required by the Municipal Code, the OCA provides an annual update to the City Council on the current status of open audit recommendations.
- Advisory Roles – the City Auditor serves as an advisor to the Utilities Risk Oversight Committee, the Library Bond Oversight Committee, the Information Technology Governance Review Board, and the Information Security Steering Committee.

Building the Annual Work Plan

Overview

Development of the Annual Work Plan begins with the identification of the available resources within the OCA. This is defined as the number of staff hours available after vacation, training, and administrative time has been considered. Sufficient staff hours are then committed to SEA & CCR Development, Hotline Administration, SAMs, Council & Management Requests, and Monitoring & Administrative Assignments. The remaining hours are dedicated to the audits identified and prioritized through the Annual Risk Assessment Process.

Annual Work Plan Limitations

As with any plan, the OCA's Annual Work Plan is limited by the following factors:

- The OCA has finite audit resources for the execution of our audits. This means that not every risk identified can be addressed each year, but is partially mitigated by the prioritization inherent in our risk-based approach.
- Risks and priorities are subject to continuous change and the plan is required to be flexible. This could cause certain audits to be removed from the plan while others are added. All

The City's risks and priorities are subject to change requiring the Plan to be flexible.

changes to the plan are reviewed by the City Council for approval.

- Other auditors, typically state and/or federal, may perform audits within the City. The plan will be adjusted to avoid duplicate work or to provide additional audit coverage if necessary.
- The plan must align with the City Council’s priorities. Any changes to the priorities may result in adjustments to the plan.

Consideration of Audits Not Completed In FY 2013 Plan

As a result of greatly expanding the scope to accommodate the risks identified in the Inventory Management Audit as well as unanticipated time requirements for hotline investigations and staff absence in FY 2013, certain audits in the FY 2013 Plan were not completed. These audits were given special consideration for this year’s plan. Audits from the FY 2013 Plan that were not completed include:

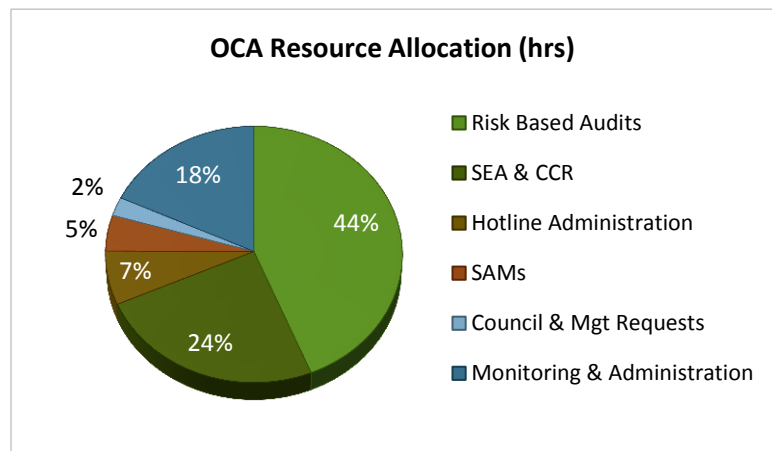
Audit Title	Status	Rationale
Development Permit Process	Postponed	Council voted to postpone this audit to allow more time for changes in the Development Center to take effect. This audit is not included in the FY 2014 audit plan due to other priorities and continuing changes.
Construction Process	Postponed	Due to other priorities, this audit was not started in FY 2013. This audit is not included in the FY 2014 audit plan due to higher risk projects being identified during the FY 2014 plan development.
Solid Waste Program	In Process	This audit was selected to replace the audit of the Development Permit Process.
Utilities Asset Management	In Process	Retitled to Inventory Management Audit. Based on our Preliminary Survey, this audit was greatly expanded in scope to address inventory management at the Municipal Services Center and Water Quality Control Plant.
Utilities Contract Oversight	In Process	New audit added as a result of a hotline investigation.
Wastewater Treatment Fund	Cancelled	Based on our preliminary survey and discussions with department management, it was determined that an audit in this area is currently low priority.
Pcard and/or Payroll Analytic Development	Postponed	Due to other priorities, this work was not started in FY 2013. This is not included in the FY 2014 audit plan due to higher risk projects being identified during the FY 2014 plan development.

OCA Annual Work Plan Resource Allocation

As discussed above, the Annual Work Plan is limited by the finite resources of the OCA. The chart summarizes available staff hours and how they are applied to the various components of the plan. The plan may be adjusted throughout the year to accommodate the changing risk environment. If a situation arises that requires OCA attention and resources are not available, the City Auditor may request additional funding from the City Council to support the use of external, supplementary resources.

Audits Selected for the Fiscal Year 2014 Work Plan

The following table summarizes the audits selected for this year’s Work Plan:



Audit	Department	Preliminary Scope*	Planned Hours*	Council Committee
Inventory Management <i>(formerly Utilities Asset Management)</i>	ASD, Multiple	Carry over from FY 2013. Specific concerns regarding the effective and efficient safeguarding of certain assets were identified during the risk assessment process. This audit will follow up on those concerns and assess the adequacy of controls over Utilities assets including compliance with relevant policies and the Municipal Code.	360	P&S
Solid Waste Program	Public Works	Carry over from FY 2013. Determine whether there are adequate controls in place to effectively manage the City's Solid Waste Program to ensure sufficient revenue to recover the cost of services while pursuing zero waste goals in accordance with applicable laws, regulations, and City policies and procedures.	650	Finance
Utilities Contract Oversight	Utilities, ASD	Carry over from FY 2013. This is a new audit created as a result of a hotline investigation. The audit reviews the efficiency and effectiveness of controls over certain Utilities Department contracts.	200	Finance
Software License Management	IT, Multiple	The IT Department has identified ~222 applications within the City. This audit will evaluate controls over software license management to ensure the City is in compliance with relevant agreements and is using all licenses it is paying for. Will carry over into FY 2015.	600	P&S
Construction Project – Change Order Management	Public Works	Evaluate the efficiency and effectiveness of controls over the change order process within a major construction project. Will carry over into FY 2015.	800	P&S
Utilities – Contract Solicitation and Award	Utilities	Evaluate the efficiency and effectiveness of controls over contract solicitation and award within the Utilities Department.	720	Finance

*Preliminary scope and/or planned hours may change based upon the preliminary survey of the audit.



POLICY AND SERVICES COMMITTEE EXCERPT

Special Meeting
September 10, 2013

City Auditor's Office Fiscal Year 2014 Proposed Work Plan and Risk Assessment.

Jim Pelletier, City Auditor, requested approval of the work plan of audits. The work plan indicated the audits the Auditor's Office would perform, not the monitoring and administrative assignments. The first few audits were brought forward from previous years. The proposed new audits involved software license management, change order management related to a construction project, and contract management in the Utilities Department. He suggested the Acting Auditor provide recommendations to adjust the plan at the next quarterly update because he would be departing from the City, the work plan was unattainable.

Council Member Klein requested an audit of disability claims and programs. He also wanted to understand why the process for hiring a consultant seemed to require an excessive amount of time.

Mr. Pelletier inquired whether Council Member Klein was concerned with the timing between the Council decision and getting a consultant on board.

Council Member Klein felt the time between the Council approving a requisition for a consultant and/or a new employee and an announcement of an opening was excessive.

Chair Price asked if Council Member Klein was focusing on outside consultants.

Council Member Klein said he was focusing on consultants filling employee positions.

Pam Antil, Assistant City Manager, indicated the Purchasing Department would approve hiring a recruiter to perform recruitment.

Mr. Pelletier reiterated that Council Member Klein was concerned with the time between Council action and having a contract in place.

EXCERPT

Council Member Klein agreed. He suggested a third audit concerning the enforcement of public benefits.

Mr. Pelletier indicated that audit was on the list to perform. He asked if the Policy and Services Committee (Committee) wanted to replace one or more of the audits on the plan with one or more of the suggested audits or consider the audit for a future work plan.

Council Member Klein requested an audit of enforcement of public benefits be considered when the new plan was presented to the Committee.

Mr. Pelletier would ensure the Acting Auditor considered the suggestions in his/her status update in the next quarter.

Chair Price stated the articulation of public benefits should be sufficiently clear and measurable so that enforcement was possible.

Council Member Klein indicated the articulation of public benefits was a Council responsibility.

Chair Price remarked that only clear and identifiable public benefits could be enforced.

Council Member Holman felt the Auditor needed to understand the Ordinance in order to understand the enforcement of public benefits.

Mr. Pelletier was concerned because the Council set the requirements for the Planned Community (PC) Zone. The City Auditor had no authority to audit the Council. The Auditor would not have the expertise needed to comment on whether or not the City Attorney worded an Ordinance properly. The Auditor could audit the enforcement of public benefits.

Chair Price inquired whether the Auditor could review the current process.

Mr. Pelletier was comfortable the Auditor could audit how the City enforced public benefits.

Council Member Holman requested an audit of parking funds.

Mr. Pelletier would consider an audit of parking funds.

Chair Price asked if the City Auditor had sufficient time to perform the audits while maintaining ongoing work. She noted there were 40 new audit recommendations.

EXCERPT

Mr. Pelletier responded yes. The audit recommendations resulted from the audits completed in the prior year.

Chair Price inquired whether the current audits would yield additional recommendations for future audits.

Mr. Pelletier replied yes. The number of audits assigned was based on the number of hours remaining after subtracting the number of hours required for ongoing work from the total available hours of employees.

Council Member Holman wished to ensure a Motion did not include the audits requested by Council Member Klein and her.

Mr. Pelletier would consider the suggested audits in the new work plan. They would be added to the list of projects as priority audits.

Council Member Klein asked if the Council could revise the priority of audits once the new City Auditor provided a work plan.

Mr. Pelletier would adjust the work plan according to the Council's priorities.

Chair Price noted the Committee could act when the new plan was presented at the next quarterly update.

Mr. Pelletier stated the audits in process would require time to complete; therefore, the Committee did not need to make a decision at the current time. The Auditor needed time to determine whether he had sufficient time and expertise to perform the audits.

Council Member Holman inquired whether the Auditor would highlight those audits that did not require a full audit.

Mr. Pelletier responded yes, that would be part of the discussion.

MOTION: Council Member Klein moved, seconded by Council Member Holman to recommend the City Council approve the City Auditor's Office Fiscal Year 2014 Proposed Work Plan and Risk Assessment.

MOTION PASSED: 3-0 Kniss absent