



CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

January 26, 2015

The Honorable City Council
Palo Alto, California

Policy and Services Committee Recommendation to Accept the Triennial External Quality Control Review of the Office of the City Auditor

The Office of the City Auditor recommends acceptance of the Triennial External Quality Control Review of the Office of the City Auditor. At its meeting on December 9, 2014, the Policy and Services Committee approved and unanimously recommended the City Council accept the report. The Policy and Services Committee minutes are included in this packet.

Respectfully submitted,

Harriet Richardson
City Auditor

ATTACHMENTS:

- Attachment A: Triennial External Quality Control Review of the Office of the City Auditor (PDF)
- Attachment B: Policy and Services Committee Meeting Minutes Excerpt (December 9, 2014) (PDF)

Department Head: Harriet Richardson, City Auditor



CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

December 9, 2014

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

Triennial External Quality Control Review of the Office of the City Auditor

BACKGROUND

The Office of the City Auditor follows Government Auditing Standards, established by the Comptroller General of the United States. The standards provide a framework for conducting high quality audits with competence, integrity, objectivity, and independence. The Government Auditing Standards are mandated for use by federal audit agencies, but because they are written by government and for government, the standards are often adopted for use by state and local government audit offices. Government audit offices that use the standards are required to establish and maintain a system of internal quality control (i.e., policies and procedures) to ensure that their audits comply with the standards and to have an external quality control review, also known as a “peer review,” at least once every three years to assess the organization’s compliance with the standards. The attached letter and report contain the results of our most recent peer review.

Last month, government audit professionals from the City of Toronto, Canada, and the City and County of Honolulu, HI, came to our office to conduct our peer review. Their review included reviewing our written policies and procedures, our internal monitoring procedures, the work we did to complete a sample of audit and nonaudit service engagements, and our compliance with continuing professional education requirements. The peer review was coordinated through the Association of Local Government Auditors. The team found that our office fully complied with the Government Auditing Standards for the period July 1, 2011, through April 14, 2014. The Office of the City Auditor recommends the Policy and Services Committee review and recommend to the City Council acceptance of the Triennial External Quality Control Review of the Office of the City Auditor.

Respectfully submitted,

Harriet Richardson, CPA, CIA, CGAP, CRMA
City Auditor

ATTACHMENTS:

- Attachment A: External Quality Control Review Results (PDF)
- Attachment B: Response to Management Letter (PDF)

Department Head: Harriet Richardson, City Auditor



External Quality Control Review

of the
Office of City Auditor
Palo Alto, California

Conducted in accordance with guidelines of the
**Association of Local Government
Auditors**

for the period July 1, 2011 to April 14, 2014



Association of Local Government Auditors

November 6, 2014

Ms. Harriet Richardson
City Auditor
City of Palo Alto
Office of the City Auditor

Dear Ms. Richardson,

We have completed a peer review of the City of Palo Alto Office of the City Auditor for the period July 1, 2011 through April 14, 2014. In conducting our review, we followed the standards and guidelines contained in the *Peer Review Guide* published by the Association of Local Government Auditors (ALGA).

We reviewed the internal quality control system of your audit organization and conducted tests in order to determine whether your internal quality control system operated to provide reasonable assurance of compliance with *Government Auditing Standards* issued by the Comptroller General of the United States. Our procedures included:

- Reviewing the audit organization's written policies and procedures;
- Reviewing internal monitoring procedures;
- Reviewing a sample of audit and non audit engagements and working papers;
- Reviewing documents related to independence, training, and development of auditing staff; and,
- Interviewing auditing staff, and a member of City Council to assess their understanding of, and compliance with, relevant quality control policies and procedures.

Due to variances in individual performance and judgment, compliance does not imply adherence to standards in every case, but does imply adherence in most situations.

Based on the results of our review, it is our opinion that the Office of the City Auditor's internal quality control system was suitably designed and operating effectively to provide reasonable assurance of compliance with *Government Auditing Standards* for audits and attestation engagements during the period from July 1, 2011 through April 14, 2014.

We have prepared a separate letter offering suggestions to further strengthen your internal quality control system.

Jeff Griffiths
Team Leader
Auditor General
City of Toronto

Van Lee
Team Member
Deputy City Auditor
City and County of Honolulu



Association of Local Government Auditors

November 6, 2014

Ms. Harriet Richardson
City Auditor
City of Palo Alto
Office of the City Auditor

Dear Ms. Richardson,

We have completed a peer review of the City of Palo Alto Office of the City Auditor for the period July 1, 2011 through April 14, 2014, and issued our report thereon dated November 6, 2014. We are issuing this companion letter to offer certain observations and suggestions resulting from our peer review.

We would like to mention certain areas in which we believe your office excels:

- The quality and content of your audit reports are excellent. They are extremely well written, clear and contain practical recommendations and are supported by meaningful graphics. The quality of your reports has been recognized nationally by the Association of Local Government Auditors for reports issued in both 2011 and 2013.
- The current audit staff are professional, well qualified and have an excellent understanding of *Government Auditing Standards (GAS)*.
- Your updated Audit Policies and Procedures Manual dated October 13, 2014 is comprehensive and complete and will serve the office well in the future.

We offer the following observations and suggestions to enhance your organizations adherence to *Government Auditing Standards*:

- GAS 6.83(c) states that auditors should document the extent of supervisory review before the audit report is issued. The supervisory review of working papers in a number of the files occurred subsequent to the issuance of the report. We recommend supervisory review occur before the audit report is issued to ensure adequate evidence is present to support the findings, conclusions and recommendations in the audit report.
- GAS 2.12 states when performing nonaudit services audit organizations should communicate with requestors or those charged with governance to clarify work performed does not constitute an audit conducted in accordance with GAS. GAS 3.34 states before an auditor agrees to provide a nonaudit service, the auditor should determine whether performing the service would create a potential threat to independence. GAS 3.42 states an auditor who previously performed nonaudit services for an entity that is a prospective audit subject should evaluate the impact of those nonaudit services on independence before accepting an audit. During the review period, we found policy surrounding standards related to nonaudit services as they relate to the audit quality did not exist. Further, the files we reviewed lacked evidence of the applicable nonaudit standards being followed. We recommend that the City Auditor ensure that the policies and procedures pertaining to nonaudit services specified in the Audit Policy and Procedures Manual, dated October 13, 2014 be followed.

- GAS 6.30 through 6.32 states auditors should assess risks of fraud that are significant within the context of the audit objectives and design (or extend) procedures to obtain reasonable assurance of detecting such fraud. While such discussions may be occurring during your assessment of overall audit risk, we recommend the identification of fraud risks, along with how the associated work will address them should be documented.

We extend our thanks to you, your staff and the other city officials we met for the hospitality and cooperation extended to us during our review.

Sincerely,



Jeffrey Griffiths,
Team Leader
Auditor General
City of Toronto



Van Lee
Team Member
Deputy City Auditor
City and County of Honolulu



OFFICE OF THE CITY AUDITOR

CITY OF
**PALO
ALTO**250 Hamilton Avenue, 7th Floor
Palo Alto, CA 94301
650.329.2392

November 6, 2014

Mr. Jeffrey Griffiths
Auditor General, City of TorontoMr. Van Lee
Deputy City Auditor, City and County of Honolulu

Dear Mr. Griffiths and Mr. Lee,

Thank you for conducting the external quality control review of the City of Palo Alto's Office of the City Auditor, which the *Government Auditing Standards* required to be conducted every three years. We are committed to continuously improving and refining our audit processes, and this review allows us to identify ways in which we can improve. We are very pleased that your review found that audits we performed complied with *Government Auditing Standards*.

We appreciate your thorough review and thoughtful feedback on our audit processes and your acknowledgement of the high quality of our reports and audit staff, and that our updated Audit Policies and Procedures Manual, dated October 13, 2014, will serve the office well in the future.

We appreciate the observations and suggestions you provided for our office to enhance our adherence to *Government Auditing Standards* and agree with your recommendations. Our updated Audit Policies and Procedures Manual, dated October 13, 2014, includes specific language to ensure adherence to each of these *Government Auditing Standards* requirements:

- Ensure that we document the extent of supervisory review before issuing an audit report – Our updated Audit Policies and Procedures Manual states, “The City Auditor will review and approve all workpapers and reports *prior* [emphasis added] to issuing the audit to ensure that all findings, recommendations, and conclusions are appropriate and supported, and that the audit was performed in accordance with GAGAS. The City Auditor may delegate workpaper review to a senior performance auditor if necessitated by time constraints. If delegated, the reviewer must follow the procedures for workpaper review.”
- Follow *Government Auditing Standards* requirements for conducting nonaudit services – Our updated Audit Policies and Procedures Manual includes a chapter dedicated to performing nonaudit services to ensure that we appropriately assess our independence prior to performing a nonaudit service and that we follow *Government Auditing Standards* requirements for management oversight of nonaudit services and acceptance of the outcomes. We also have a template to guide us through the required procedures, which we require to be used prior to performing any nonaudit service.
- Fully document our assessment of fraud risks for each audit – Our updated Audit Policies and Procedures Manual requires audit staff to conduct a project-based risk assessment during the



planning phase of each audit. The risk assessment must specifically consider whether each risk represents a fraud risk, and our Audit Policies and Procedures Manual provides sample questions to help determine if fraud has occurred in the past or has the potential to occur in the future. We also have a risk-assessment template that audit staff are required to use to document the risk assessment.

We would like to express our sincere appreciation to the peer review team and the Association of Local Government Auditors for their work and commitment to ensuring that government auditors adhere to *Government Auditing Standards*, which provide decision makers and the public with high quality audit reports.

Respectfully,

A handwritten signature in cursive script that reads "Harriet Richardson".

Harriet Richardson, CPA, CIA, CGAP, CRMA
City Auditor



POLICY AND SERVICES COMMITTEE DRAFT MINUTES

Regular Meeting
Tuesday, December 9, 2014

Chairperson Price called the meeting to order at 6:02 P.M. in the Council Conference Room, 250 Hamilton Avenue, Palo Alto, California.

Present: Price (Chair), Scharff, Schmid

Absent: Klein

ORAL COMMUNICATIONS

None

AGENDA ITEMS

1. Triennial External Quality Control Review of the Office of the City Auditor

Harriet Richardson, City Auditor, stated the Government Auditing Standards "Standards" require auditors offices that follow the standards to have a peer review every three years. In order to ensure compliance with the standards, the triennial peer review was conducted through the Association of Local Government Auditors (ALGA). The most recent peer review covered the period of July 1, 2011 to April 14, 2014; the period was short of the three year time because of her start date. The peer review team reviewed the City Auditor's policies and procedures manual and a mix of audit and nonaudit reports completed by the office to ensure they were performed in accordance with the standards. The reviewers concluded that the City Auditor's policies and procedures manual and work performed were in compliance with the standards. They suggested improvements in three areas to enhance the compliance with the standards; they advised that the updated policies and procedures manual was comprehensive and complete and would serve the office well in the future. The suggested areas for improvement were; 1) document supervisory review of audits; this process should occur prior to the issuance of the report 2) appropriately evaluate the office's independence regarding nonaudit services, and 3) assess and

document the assessment of risks of fraud; there has since been a risk assessment process put into place to effectively perform the requested task. The peer review team recommended to the City Council that the Office of Management and Budget (OMB) not review the City Auditor's office budget prior to being submitted to the Council for annual approval. She accepted each of the recommendations and incorporated them into the updated policies and procedures manual which was currently in use by the City Auditor Staff.

Council Member Schmid mentioned he spoke to the visiting audit team. There was interest in the office reporting directly to the City Council and whether or not the City Manager managed or oversaw the budget of the City Auditor's office. He questioned why the audits being reviewed did not include the time period Ms. Richardson was on Staff.

Ms. Richardson stated the work the review team audited was completed. The work that had been started since her appointment was not completed and therefore not ready for review. The next review would cover the full three-year period.

Council Member Schmid asked to define the boundaries of nonaudit work versus audit work.

Ms. Richardson stated the boundary was not as clear as she would prefer. The Standards defined nonaudit services as anything that was not an audit. There was a clear definition of what an audit was and therefore anything outside of that designation was considered nonaudit. An audit consisted of an evaluation of audit evidence and an analysis to draw a conclusion. There were times where an analysis was performed on nonaudit work and some consider that that should be considered an audit. As chair of ALGA'S Professional Issues Committee, she was working with the Government Accountability Office in Washington D.C. to provide input on issues faced by audit offices on the nonclarity of the audit versus nonaudit.

Council Member Schmid said the Auditor sat on the Ethics Committee and he assumed that was considered nonaudit work.

Ms. Richardson clarified she was not a seated member of the Ethics Committee; although, her office provided input into the ethics policy.

Chair Price noted Council Member Schmid was referring to the Fraud Hot Line.

Ms. Richardson noted the Hot Line was considered nonaudit work. She mentioned that was an unclear area, when the office was performing an investigation.

Council Member Schmid asked if the role in an investigation was not driven by an audit.

Mr. Richardson stated that was correct.

Council Member Schmid said it was based on the judgment of the Auditor.

Ms. Richardson stated that was correct. She added most of the investigations were not handled directly by the Auditor's office but the information was directed to the Department Head.

Council Member Schmid asked if at some point there were to be a tip of financial fraud, would the Auditor's Office create an audit and investigate.

Ms. Richardson stated that was correct. There had been a situation in her prior employ and the approach was an actual audit.

Council Member Schmid asked if the nonaudit work created a conflict with the audit work.

Ms. Richardson said it depended on the method of the audit. If the approach was on the weaknesses that allowed for the loss of funds it would not be considered an impairment.

Council Member Schmid asked if the performance report was nonaudit work.

Ms. Richardson noted that specific work was treated as an audit. The standards were written so the principles were applicable based on the audit objectives. The performance report was a compilation of data from different departments rather than analysis; therefore, the Auditor's Office was not drawing conclusions and thus not impairing their independence.

Council Member Scharff asked if the City of Berkeley had an elected auditor.

Ms. Richardson said yes.

Council Member Scharff said in places where there was not an elected auditor, how was their office budget typically processed.

Ms. Richardson stated the budget area varied widely. In the incident of the peer review auditors, both of their office budgets were sent directly to their legislative body and not through the budget office.

Council Member Scharff asked if the review team suggested the Auditor's Office put together a budget and have it routed directly through the City Council rather than through the Budget Office.

Ms. Richardson said that was correct.

Council Member Scharff asked if she was going to raise the issue with the City Manager or if she wished for the Council to discuss the matter.

Ms. Richardson suggested addressing how the City Manager desired to approach the recommendation.

Council Member Scharff noted the Auditor's Office was a Council Appointed Office (CAO) and, therefore, if there were budget process changes, the discussion should be considered for all four CAO offices.

Ms. Richardson understood and asked if the Policy & Services Committee (Committee) wished for her to approach the other CAO offices.

Council Member Scharff considered the question and asked how other cities handled their budget models regarding similar offices.

Ms. Richardson noted the Auditor General from Toronto; one of the peer review team members, followed the budget guidelines of his city with the exception that he turned his budget directly into the legislature rather than the budget office for review and approval.

Molly Stump, City Attorney, agreed to consult with the other CAO's to review budget processes within the CAO offices. She felt the Budget director should be highly involved to ensure their structure matched the City's overall budget.

Khashayar "Cash" Alaei, Senior Management Analyst, mentioned the budget process went before the Finance Committee and the CAO's had ample opportunity to meet with the Council on their budgets and there were safeguards placed in the process for all offices.

Council Member Scharff asked how the peer review audit was performed.

Ms. Richardson stated the external auditors were on site for a week but the background information; history of peer reviews, prior recommendations,

policies and procedures, along with a list of work completed in the past three years was sent out a few months in advance. The peer review team selected a sampling of work they wished to review. When they arrived at the location they were set up in an office and requested the files be pulled as needed.

Council Member Scharff asked if the review team interviewed the Auditor Staff.

Ms. Richardson stated the process varied depending on the organization. This specific organization requested to interview the Auditor Staff and a selected City Council Member from the Standing Committee the office presented to.

Council Member Scharff asked where the reviewers were set-up for the week.

Ms. Richardson said there was a vacant office in the City Manager's area that they occupied.

Council Member Scharff confirmed the team reviewed the requested files and if there were questions they spoke to the Staff member responsible for that audit.

Ms. Richardson stated that was correct.

Chair Price stated the City Auditor had mentioned Special Advisory Memo (SAM), she asked for more specifics. She recalled that was under the prior Auditor and noted the program was discontinued. She asked if there was a relationship with the nonaudit activities.

Ms. Richardson stated yes; the prior Auditor worked on nonaudit activities and presented the information as SAM's. There was a specific concern because the SAM's looked as if an audit had been performed and the office should have been following the independence requirements when they were completed.

MOTION: Chair Price moved, seconded by Council Member Schmid that the Policy & Services Committee approve and recommend to the City Council acceptance of the Triennial External Quality Control Review from the Office of the City Auditor.

MOTION PASSED: 3-0 Klein absent