

**City of Carson City
Agenda Report**

Date Submitted: April 7, 2008

Agenda Date Requested: April 17, 2008

Time Requested: Consent Agenda

To: Mayor and Supervisors

From: Internal Audit Department

Subject Title: Action to accept the recommendations of the Audit Committee to adopt the "Carson City Audit Manual" as the guideline that will be used for audits conducted within the Internal Audit Department.

Staff Summary:

At the April 8th, 2008 Audit Committee meeting the "Carson City Audit Manual" was reviewed and discussed. The Audit Committee approved this document by a vote of 5 to 0 as the guideline that will be followed in audits conducted by the Internal Audit Department. The manual will be provided to each auditee prior to an engagement beginning in order that they will have an overview and a better understanding of the audit process.

Type of Action Requested: (check one)

Resolution

Ordinance

Formal Action/Motion

Other (Status Report)

Does this action require a Business Impact Statement: () Yes (X) No

Recommended Board Action: I move to accept the recommendations of the Audit Committee to adopt the "Carson City Audit Manual" as the guideline that will be used for audits conducted within the Internal Audit Department.

Explanation for Recommended Board Action: Adopting the "Carson City Audit Manual" will provide and overview and understanding of the audit process for the auditee and provide consistency in how audits will be performed by the Internal Audit Department of the City.

Applicable Statute, Code, Policy, Rule or Regulation: N/A

Fiscal Impact: Per audit potential cost savings, cost avoidance, cost containment

Explanation of Impact: May result on a per audit basis.

Funding Source: Budget of the Internal Audit Department.

Alternatives: Modify or do not approve Audit Work Plan.

Supporting Material: See attached.

Prepared by: Sue Johnson

Reviewed by: [Signature]
(Department Head)

Date: 4/9/8

: [Signature]
(City Manager)

Date: 4-9-08

: [Signature]
(District Attorney)

Date: 4-9-08

: [Signature]
(Director of Finance)

Date: 4/9/8

Board Action Taken:

Motion: _____

1) _____	Aye/Nay
2) _____	_____

(Vote Recorded By)

CARSON CITY INTERNAL AUDIT MANUAL



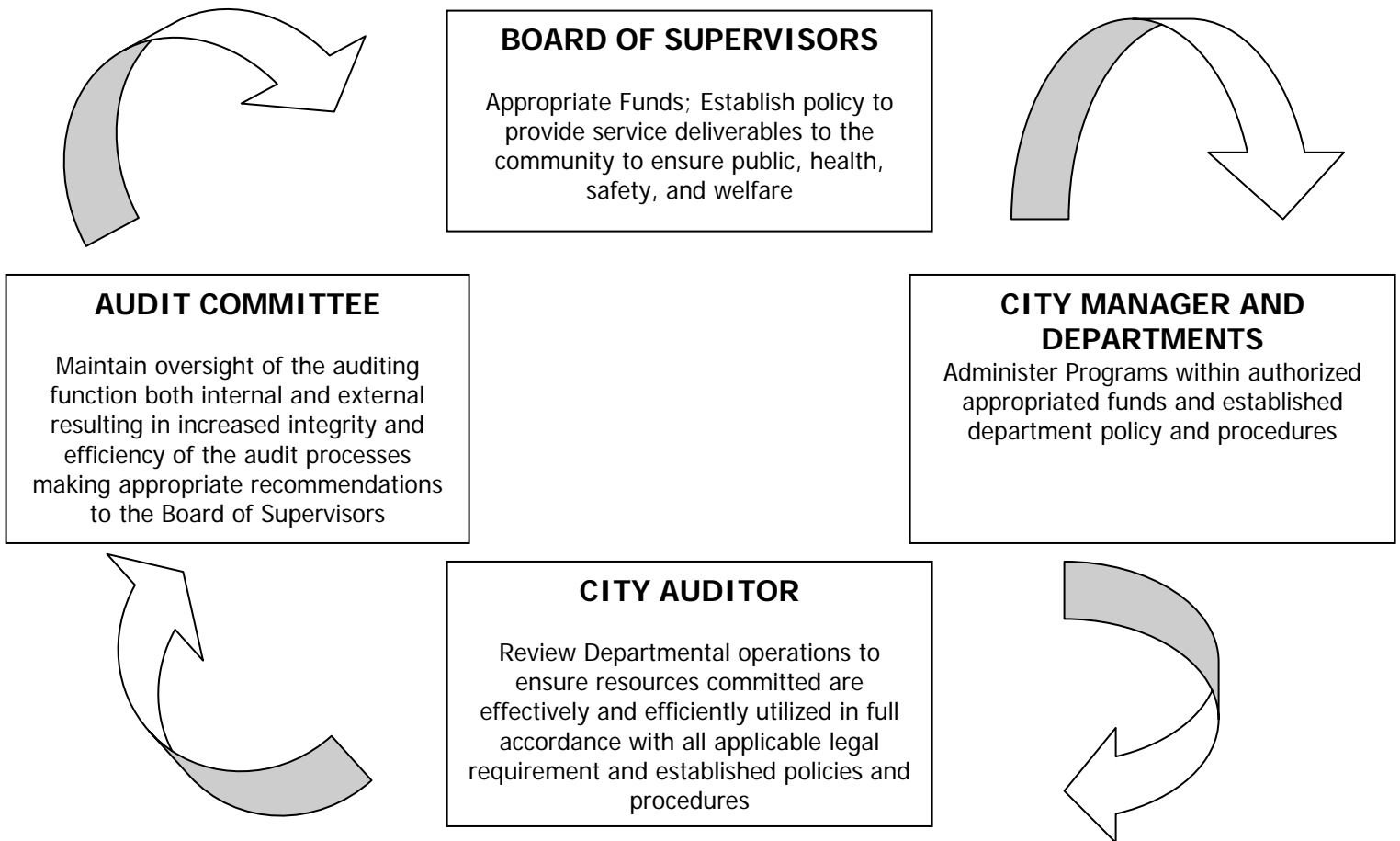
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O V E R V I E W

THE ROLE OF AUDITING IN CITY GOVERNMENT

The City Auditor's audits and reviews provide an insight into City departments, offices, agencies, and their programs. Such audits and reviews are but one step in the process of establishing City programs, evaluating their performance, providing the Board of Supervisors and City Administration with needed information, and making any necessary changes to ensure that City programs are as efficient and effective as possible. The Chart below illustrates the role of auditing in City government.



OVERVIEW OF AUDIT PROCESS

The mission of the City Audit Department is to assist the Board of Supervisors, City management, and City employees in the effective performance of their duties by providing them with an objective evaluation of City departments, systems and activities. An audit is successful when it results in management's implementation of beneficial improvements to the City's programs and activities.

For some, the prospect of being audited can bring on feelings of anxiety. These feelings are often related to fear of the unknown. By describing the purpose of an audit, and answering some general questions about an audit, it is hoped that this anxiety can be relieved before it begins.

WHY WAS MY AREA SELECTED FOR AN AUDIT?

The City Auditor prepares and submits an annual audit plan to the Audit Committee for review and then to the Board of Supervisors for approval. Areas are selected for audit based on potential for cost savings, service improvements, level of public and Board interest, evidence of issues, etc.

HOW WILL THE AUDIT PROCESS WORK?

An audit will generally proceed as follows:

1. **Initial Contact** – Notice is given that an audit will be initiated. A pre-audit conference will be held with City Management/Department Heads to discuss the audit objectives, audit process, time frames, and data needs.
2. **Information Gathering** – Through interviews, document reviews, and observations, the auditor will gain an understanding of the subject matter sufficient to clarify detailed audit objectives and develop the audit work plan.
3. **Fieldwork** – The auditor will collect, test, and analyze sufficient information to satisfy audit objectives. Any items of concern are reviewed with the auditee as they are observed.
4. **Reporting and Follow Up** – Audit conclusions and recommendations are communicated in a draft report to management and the Audit Committee. Once the City Auditor and the department audited agree on the findings and corrective action plan, a final report is submitted to the Audit Committee who will make final recommendations to the Board of Supervisors. The City Auditor monitors the actions taken by management, and submits quarterly progress reports to the Board of Supervisors.

OVERVIEW OF AUDIT PROCESS

HOW WILL THE AUDITEE KNOW IF THERE ARE ISSUES THAT NEED ADDRESSED?

Communication will occur throughout the audit. The City Auditor will inform management of issues as they come to his/her attention. This is done for two reasons. First, the auditor may have misunderstood an issue that can be easily clarified. Secondly, if there is an issue, corrective action can begin even before the audit is completed, a point that can be mentioned in the final report.

WHAT CAN I DO TO GET THE MOST OUT OF THE AUDIT?

Consider the audit an opportunity to utilize an available resource, rather than a burden on daily operations. Be positive. The attitudes of management have a direct impact on the success of the process. Make time for the auditor, and keep an open mind to recommended new ideas or approaches. If everyone involved in the audit is committed to evaluating how the City operates and finding ways to incorporate improvements, good things will happen.

SINCE AN AUDIT IS A TEAM EFFORT, ARE THERE SOME MUTUAL EXPECTATIONS THE AUDITEE CAN HAVE ABOUT THE WORKING RELATIONSHIP?

You can expect the City Auditor to:

- Conduct themselves in a professional manner.
- Approach the assignment objectively.
- Keep management well informed during work on the assignment.
- Be open and accessible to discuss issues of concern.
- Be reasonable flexible in the scheduling of work, and to make an effort to minimize disruptions.
- Communicate the results in writing.

We expect the City employees who assist us will:

- Conduct themselves in a professional manner.
- View the process as an opportunity to improve.
- Communicate in an open and straightforward manner.
- Provide feedback to ensure accurate and relevant information is reported.
- Make time for the auditor, taking reporting deadlines into consideration.
- Provide open access to all relevant information and personnel.

**EVALUATING
EFFECTIVENESS,
EFFICIENCIES
AND INTERNAL
CONTROLS**

EVALUATING EFFECTIVENESS, EFFICIENCIES AND INTERNAL CONTROLS

Now more than ever, citizens are demanding the very highest level of accountability from government officials for their stewardship of public resources. Public-sector managers must use the resources committed to their care as effectively and efficiently as possible, in full accordance with all applicable legal requirements and established policies and procedures. These objectives can only be achieved within the framework of a sound and comprehensive system of internal controls.

OVERVIEW

Internal Controls are an integral part of how management “conducts business”. They are a coordinated set of policies and procedures that reflect a comprehensive strategy for achieving business objectives.

It is a basic principle of good management that authority and responsibility not be separated. Therefore, because management is in a position to establish and maintain internal controls, it is management that is primarily accountable for the internal controls to function properly.

Management is not free simply to act in any way it might choose to achieve the entity's goals and objectives. Their options and actions are bound by the entity's policies and procedures to ensure an adequate system of internal controls are in place.

FRAMEWORK

Effectiveness, efficiency, compliance and financial reporting are all the responsibility of management and set the framework that management uses to ensure that it has an adequate system of internal controls in place.

The following examples provide insight into how internal controls of an entity maybe analyzed to attest that an adequate system of internal controls are in place and function as designed.

1. **EFFECTIVENESS** –

Are the business objectives clearly stated?

Is the entity achieving its objectives, and intended purpose, if not why?

2. **EFFICIENCY** –

Is management making optimal use of resources (revenue & expenses) placed under its control?

Is a program meeting its defined objectives, is it too expensive to continue? Is the program effective, but inefficient? (A program cannot be economical if it does not accomplish its objectives).

EVALUATING EFFECTIVENESS, EFFICIENCIES AND INTERNAL CONTROLS

3. COMPLIANCE –

Is management's control over resources supported by documented policies, procedures, law and regulations?

Is management in compliance with these policies, procedures, laws and regulations that govern how the entity will achieve its stated objectives?

4. FINANCIAL REPORTING –

Managers are financial decision makers; does management follow up and prepare financial information to evaluate the objectives and decisions made to understand the financial implications, and make appropriate recommendations to the governing board going forward?

Are amendments to contracts presented to the BOS for evaluation and final approval?

MANAGEMENT'S ROLE

A system of internal controls, no matter how well designed, can not function properly without the knowledge and support of management at all levels.

The comprehensiveness of an entity's internal control framework may be assessed on the basis of whether management achieves the following:

1. MANAGEMENT SUPPORTS A FAVORABLE CONTROL ENVIRONMENT –

Is management knowledgeable about internal controls?

Is management committed to establishing and maintaining controls?

Does management communicate its support for internal controls to staff at all levels? Attempting to make internal controls function effectively in an indifferent environment is likely to be a frustrating and counter productive.

2. CONTINUALLY ASSESS RISK –

Does management identify risks that may hamper or prevent it from fulfilling its objectives?

Are these risks from within the entity or are these risks external to the entity?

Does management anticipate these risks, and identify alternatives so that objectives can be obtained? How are these alternatives communicated to the governing board, is communication timely?

EVALUATING EFFECTIVENESS, EFFICIENCIES AND INTERNAL CONTROLS

3. ESTABLISHES AND MAINTAINS EFFECTIVE CONTROL RELATED POLICIES AND PROCEDURES –

Does the manager have clearly defined policies and procedures in place that reflect the current business environment? i.e.:

- Authorization levels defined by positions/management/BOS
- Approval of Transactions
- Appropriate detail and support for all transactions
- Security over assets and records
- Segregation of duties
- Periodic reconciliations
- Periodic verifications
- Analytical review of prepared budgets
- Analytical review of financial statements

4. EFFECTIVELY COMMUNICATES INFORMATION –

Is the right information provided to the right individuals at the right time and in the right format for decision makers to make an informed decision? Is information reliable? Is information timely?

What is the form of communication used to ensure on adequate communication exists both within and between various levels and activities of the entity as well as those outside the government?

5. MONITORS THE EFFECTIVENESS OF CONTROL POLICIES AND PROCEDURES AS WELL AS THE RESOLUTION OF POTENTIAL PROBLEMS IDENTIFIED BY THE CONTROLS –

Are documented policies and procedures followed as they were designed?

How does management handle discrepancies to the designed policy and procedures? What are the guidelines that determine when a discrepancy should be communicated to the governing body?

The cost of the control should never exceed the benefit it provides, how does management evaluate this to ensure there is adequate controls in place at a reasonable cost?

Has management identified what risks it is willing to take because the cost of preventing such risks cannot be justified?

When is management given the authority to “override” a policy and procedure, how is this documented, at what level is this taken to the governing board for discussion and for approval?

EVALUATING EFFECTIVENESS, EFFICIENCIES AND INTERNAL CONTROLS

Is there a risk of collusion, between employees' that would circumvent the controls in place?

Is there redundancy in the controls, are the controls excessive?

6. **MANAGEMENTS RESPONSIBILITIES FOR INTERNAL CONTROLS ARE CATEGORIZED AS FOLLOWS –**

DESIGN – Management is responsible for the design of policies and procedures.

IMPLEMENTATION – Management is responsible to ensure that the designed policies and procedures are followed and are placed in service.

MONITORING – Management should ensure that policies and procedures continue to function as designed; when necessary they are modified or enhanced to conform to changes in the entity's operating environment.

REPORTING – Management should keep the governing board apprised of how internal controls are functioning; this can be done with the assistance of internal audit or external audit resources.

**INTERNAL AUDIT
FOCUS
VS
EXTERNAL AUDIT
FOCUS**

INTERNAL AUDIT FOCUS VS.EXTERNAL AUDIT FOCUS

EXTERNAL AUDITING

OBJECTIVE – Primarily focused on financial statement audit and what materially effects the financial statements

TYPES OF AUDITS PERFORMED

1. **Financial Statement Audits** – This is the examination of the financial planning and reporting process, the reliability and integrity of financial records, and the preparation of the annual financial statements.

INTERNAL AUDITING

OBJECTIVE – Primarily focused on a comprehensive understanding of an organization systems, people and objectives as a whole

TYPES OF AUDITS PERFORMED

1. **Operational Audit** – The systematic review and evaluation of a specific topic to determine whether it is functioning effectively and efficiently, whether it is accomplishing established goals and utilizing all of its resources appropriately.
2. **Program Audit** – Evaluates whether the stated goals or objectives for a project or initiative have been achieved.
3. **Fraud Audit** – Investigates whether the organization has suffered through misappropriation of assets, manipulation of data, and omission of information.
4. **Ethical Business Practice Audit** – Determines the extent to which the organization, management, and employees support established codes of conduct, purchasing policies, disbursement policies, etc.
5. **Compliance Audit** – Determines whether a process or transaction is or is not following applicable rules developed internally by the organization/departments.
6. **System Development and Life Cycle Review** – An information system audit conducted in partnership with operating personnel who are implementing a new information system. The objective is to independently test the system at various stages throughout the design, development and installation to identify issues and correct problems early.

AUDIT PROCESS

- * INITIATING AN AUDIT**
- * PRE-AUDIT CONFERENCE**
- * PRELIMINARY SURVEY**
- * FINDING WORKSHEET**
- * AUDIT PROGRAM**
- * MEMORANDUM SUMMARIZING ACCOMPLISHMENTS**
- * DRAFT REPORT**
- * FINAL REPORT**



Initiating an Audit Memo – Sample

CITY OF CARSON CITY

TO: BOARD OF SUPERVISORS

FROM: City Auditor

SUBJECT: INITIATING AN AUDIT

DATE: Month, day, year

In accordance with the City Auditor's approved 200X-200X Workplan, I am initiating an audit of the _____ department and _____ programs.

The purpose of this letter is to determine if you have any interests or concern about the _____ Department's and _____ programs that I can address in the audit. This inquiry is preparatory to designing the scope of the audit and it intended to ensure that the audit will be responsive to your needs.

If you would like the audit of the _____ Department's and _____ programs to include any specific areas, please let me know not later than _____, 2008.

Should you have any questions, please contact me at extension 30457.

Respectfully Submitted,

City Auditor



LETTER INITIATING PRE-AUDIT CONFERENCE

Date:
To: City Manager/Department Head
From: City Auditor
Re: Title of Performance Audit

In accordance with the City Auditor's approved 200X-200X Work plan, I am initiating an audit of the _____ Program of the _____ Department.

In order to commence the audit, I will be scheduling a pre-audit conference to discuss the audit objectives, audit process, time frames, and data needs. Rose Gardner will contact you to arrange this meeting with yourself and members of your management staff.

Accordingly, please provide me with the following preliminary information about the _____ department and _____ programs:

1. An organizational chart and/or listing of key Department Personnel, Advisory Committees, Board of Authorities, and the Board of Supervisors;
2. Criteria, descriptions, and/or Program brochures which provide detailed background information and history of Programs;
3. Copy of department written policy and procedures that support the processes of managing the Programs;
4. Management reports, financial reports, and budget information on the programs for the past three years which clearly illustrate the inflow of revenues and outflow of expenditures;
5. Memorandum summarizing Program accomplishments

A draft report will be prepared based upon the audit findings. You will have an opportunity to review the draft report and provide written comments for inclusion into the final audit report which will be presented to the Board of Supervisors. You will also have the opportunity to include a memorandum of program accomplishments in the final report.

I look forward to working with you and your team to ensure that the City's Programs are efficient and effective and are bound by the department's written policies and procedures providing for an adequate system of internal controls.

If you have questions, or need additionally information, please contact me at extension 3057. Your cooperation is greatly appreciated.

Respectfully,

City Auditor

PRELIMINARY SURVEY INTERNAL AUDIT PROGRAM

OBJECTIVE

To develop an audit program that addresses the areas of greatest risk, or opportunities to improve the efficiency and effectiveness of services and programs.

This will be accomplished in the following steps by gathering historical, organizational and financial information that will help to familiarize the auditor regarding the audit subject, provide the background data for the audit report and facilitate subsequent risk assessment and testing procedures. The results obtained control the nature and extent of auditing procedures and tests to be conducted during the examination.

This survey is used for all departments of the City of Carson City in conjunction with an internal audit assignment.

1. Obtain copies of any departmental brochures, public relations literature, press releases, etc. that will provide some background information regarding the selected audit area.
2. Independently interview the City Manager and department management to obtain additional background information regarding the areas to be audited including:
 - a. Intended benefits of department/program/agency
 - b. History of organization and department objectives
 - c. Accomplishments
 - d. Current objectives
 - e. Workload, peak periods, and backlog
 - f. Identified issues or obstacles
3. Obtain or draw a chart of the organization including all Advisory Boards and the Board of Supervisors as it relates to the areas to be audited
 - a. Identify key programs
 - b. Describe key staff responsibilities for administering and/or monitoring of key programs
4. Interview staff, walk-through and/or observe Department processes/activities to become familiar with (1) how the programs are designed to work, (2) how the programs are actually working, and (3) the data systems used within the Department.
5. Flowchart or describe the departmental procedures affecting the audit area.
 - a. Obtain a copy of the departments written procedures
6. Identify relevant forms, files and management reports utilized by the department to accomplish program objectives:
 - a. Review contents, organization, purpose of files, and record retention policy
 - b. Obtain samples of forms and files if appropriate
 - c. Obtain samples of internal reports (i.e. weekly, monthly, activity reports)
 - d. Obtain samples of external reports (i.e. annual report)

**PRELIMINARY SURVEY
INTERNAL AUDIT PROGRAM**

7. Determine whether computer-processed data are an integral part of the area audited:
 - a. Obtain a copy of written procedures
 - b. Obtain copies of input forms, file layouts and names, copies of reports and printouts
 - c. Evaluate the most recent contingency plan submitted to IT for disaster recovery

8. Determine the reports that the Advisory Boards and/or Board of Supervisors receive concerning:
 - a. Workload
 - b. Use of major program resources (budget, people, & equipment)
 - c. Achievement of program objectives
 - d. Citizen complaints and requests for service

9. From the City's financial management system obtain information regarding the audited areas revenues and expenditures for the past three fiscal years. Review the analysis of expenditure and revenue performance in the Annual Report prepared with fiscal year end audit.

10. Obtain copies of budget documents for the past three years:
 - a. Identify key program's source of funds
 - b. Identify restrictions on the use of funds
 - c. Identify the principal cost elements
 - d. Identify revenues or reimbursements collected in conjunction with audited areas
 - e. Review budget justifications
 - f. Note reasons for budget cuts or augmentations affecting audited areas

11. Review the departments Strategic Goals, Objectives, and Performance Measures for the past three years:
 - a. Consider whether the measures are appropriate to indicate accomplishment of mission
 - b. Review departments core services and special projects outlined in the City Manager's annual work plan
 - c. Consider whether special projects contribute toward the improvement of the Departments performance

12. Review recent Board of Supervisor and/or Advisory Commission activity on the audited area:
 - a. Review meeting agendas and minutes to determine which recent meetings have addressed issues related to audit topic
 - b. Obtain and review copies of minutes of pertinent meetings

13. Review prior audit reports and work papers as well as letters from the City's outside auditors for relevant criteria and also for indications of prior issues.

14. Identify the laws, regulations, and authoritative standards that should be tested for compliance.
 - a. Review the City Charter and Municipal Code sections relevant to the audit area.

**PRELIMINARY SURVEY
INTERNAL AUDIT PROGRAM**

- b. Interview or write a memo to the City Attorney to obtain assistance in identifying federal, state, or local laws, regulations, and ordinances.
- c. If the audited area involves a City contract, obtain and review an executed copy of the contract(s)
- d. Find out how the contract was selected (competitive bidding or negotiated)
- e. Obtain background information regarding the contractor
- f. Describe the contract history and key provisions

FINDING DEVELOPMENT WORKSHEET

DATE: _____

FINDING NUMBER: _____

FINDING:

CONDITION: (The existing situation, and whether isolated or widespread)

CRITERIA: (What should be?)

EFFECT: (In terms of cost, adverse performance, or other factors? What is the impact in services, dollars or people?)

CAUSE: (Who? What? Why?)

RECOMMENDATIONS: (What should be done? Who should do it? When should it be done?)

Priority # _____

AUDIT PROGRAM EXAMPLE

AUDIT TITLE _____

The title is taken from the auditors approved workplan for fiscal year 200X-200X.

OBJECTIVE(S)

The objectives have been identified through the workplan process.

- 1.
- 2.
- 3.
- 4.
- 5.

PROCEDURES

Based on the results of the "Preliminary Survey" and findings of that survey detailed audit procedures will be developed. Examples of the types of procedures are as follows:

1. Research and identify best practices in _____ policies and procedures.
2. Survey and identify _____ best practices from other jurisdictions.
3. Document internal controls for _____ for the following areas:
 - a.
 - b.
4. Establish scope and methodology for testing compliance with internal controls.
 - a. Identify items for review
 - b. Determine sample criteria
 - c. Select sample
5. Summarize audit results:
 - a. Key limitations of current process
 - b. Overall assessment and/or conclusion
 - c. Audit issues and/or findings
 - d. Extent audit steps if necessary to determine the significance of the audit issue



Memorandum Summarizing Accomplishments – Sample

CITY OF CARSON CITY

TO: DEPARTMENT MANAGEMENT FROM: City Auditor

SUBJECT: MEMORANDUM SUMMARIZING ACCOMPLISHMENTS DATE: Month, day, year

A part of the normal audit process is to request the management of the entity that is being audited provide a memorandum summarizing any major program accomplishments. These accomplishments are included in the final audit report in order to fairly present the situation and to provide appropriate balance.

Any memorandum you wish to provide should include significant management accomplishments relative to the _____ Department.

Please provide this memorandum at your earliest convenience. If you have any questions or need additional information, please feel free to contact me. Your cooperation is greatly appreciated.

Sincerely,

City Auditor



Final Draft Report Cover Memo – Sample

CITY OF CARSON CITY

TO: AUDIT COMMITTEE MEMBERS FROM: City Auditor

SUBJECT: DRAFT REPORT DATE: Month, day, year

This draft report is submitted to you for your review and comment purposes. Accordingly, please review it for content, correctness, and accuracy. As will all draft reports, the information in this report should be treated on a confidential basis until such time as a final report is issued.

Should you wish to provide a written response for inclusion, please do so by _____, 2008.

The Audit Committee agenda for the meeting on _____, 2008 will include this draft report for discussion.

Please contact me if you have any questions.

Respectfully Submitted,

City Auditor



Draft Report - Example
AUDIT SUMMARY

INTRODUCTION

The review was conducted as an assessment.....

SCOPE AND METHODOLOGY

The purpose of this audit was to perform This review included the following objectives:

1.
2.

The audit work performed consisted of interviews, observations, and a review of specific documentation that was deemed to be sufficient to determine the existence and effectiveness of processes currently in place; to provide support for recommendations provided within this report.

EVALUATION AND COMMENTS

Overall,

FINDINGS AND RECOMMENDATIONS

Internal Audit noted issues that present opportunities for immediate improvement with respect to

1. FINDING

The audit of _____ disclosed that
.....

Internal Audit reviewed _____ for compliance with the current policies and procedures in place. Based on this review the following weaknesses were identified:

- _____
- _____

RECOMMENDATIONS

Comprehensive policies and procedures should be developed addressing the weaknesses identified above.

Draft Report - Example
AUDIT SUMMARY - CONTINUED

2. FINDING

The audit of _____ revealed that

RECOMMENDATIONS

Etc.....

I appreciate the cooperation and help provided by all of the _____
Department staff.

Respectfully Submitted,

City Auditor



Final Report - Example
CITY OF CARSON CITY

DATE:

TO: CARSON CITY BOARD OF SUPERVISORS

FROM: CITY AUDITOR

RE: AUDIT TITLE

The Internal Auditor has completed an audit of _____. Results of the audit indicate that _____

The most significant findings from the audit indicate a need for _____. The results of the audit have been discussed with the department management, City Manager, and Audit Committee. The department has developed action plans for each finding with scheduled implementation dates through _____, 2008. Corrective action has already been taken in some areas.

The Internal Auditor will conduct follow-up reviews, as necessary, to verify corrective action is taken on open findings. Additional information about audit and audit can be found in the attached Internal Audit Report.

Respectfully Submitted,

City Auditor



Final Report - Example AUDIT SUMMARY

INTRODUCTION

The review was conducted as an assessment.....

SCOPE AND METHODOLOGY

The purpose of this audit was to perform This review included the following objectives:

1.
2.

The audit work performed consisted of interviews, observations, and a review of specific documentation that was deemed to be sufficient to determine the existence and effectiveness of processes currently in place; to provide support for recommendations provided within this report.

EVALUATION AND COMMENTS

Overall,

FINDINGS, RECOMMENDATIONS, AND MANAGEMENT RESPONSES

Internal Audit noted issues that present opportunities for immediate improvement with respect to

1. FINDING

The audit of _____ disclosed that

.....
Internal Audit reviewed _____ for compliance with the current policies and procedures in place. Based on this review the following weaknesses were identified:

- _____
- _____

RECOMMENDATIONS

Comprehensive policies and procedures should be developed addressing the weaknesses identified above.

MANAGEMENT RESPONSE

Agree. Revised policies and procedures are scheduled.....



**Final Report - Example
AUDIT SUMMARY**

2. FINDING

The audit of _____ revealed that

RECOMMENDATIONS

MANAGEMENT RESPONSE

Etc.....

I appreciate the cooperation and help provided by all of the _____
Department staff.

Respectfully Submitted,

City Auditor

AUDIT GUIDELINES

- * PROCEDURES**
- * SAMPLING**
- * STATISTICAL & NON STATISTICAL**
- * EVIDENCE**
- * SPECIAL REQUESTS**

AUDIT PROCEDURE GUIDELINES

OVERVIEW

There are many types of audit procedures which can be used to test transactions or processes. The audit objective determines the type of procedure to be used. The auditor must judge the evidence obtained through the audit procedures to make conclusions for each audit objective. The evaluation process requires professional judgment in determining the adequacy, efficiency, economy and effectiveness of what has been audited. The evaluation process is facilitated by the use of the "Finding Development Sheet".

AUDIT PROCEDURES

There are four primary types of audit procedures that will be used: Verification, Observation, Inquiry, and Analysis.

A. VERIFICATION

Verification is the confirmation of things such as: Assets; Records; Statements; Documents; Compliance With laws and regulations; Effectiveness of internal controls; Transactions; and Processes. The purpose of verification is to establish the accuracy, reliability or validity of something. Following is a recap of types of verification techniques that may be used:

1. **Count:** An auditor will use this technique to verify the accounting records of a physical asset by physically counting the assets.

2. **Compare:** An auditor will identify similar and/or different characteristics of information from two or more sources. Types of comparison include: (a) Comparison with prescribed standards; (b) Comparison of current operations with past or similar operations; (c) Comparison with written policies and procedures; (d) Comparison with laws or regulations; and (e) Comparison with other reasonable criteria. Specific examples are:

- To compare a law requiring that a percentage of taxes will be used for a particular program with the accounting records showing the amount of taxes and how much was spent on the program.
- To compare the documentation of a transaction with the procedure for the transaction.

3. **Examine:** To look something over carefully, such as a document, especially for the purpose of detecting flaws or irregularities. For example, an auditor may examine a document to verify that it has been executed by authorized persons.

4. **Inspect:** To look something over carefully, such as a physical asset, especially for the purpose of detecting flaws or irregularities. For example, an auditor may inspect inventory to verify quality.

AUDIT PROCEDURE GUIDELINES

5. **Foot:** To re-compute the mathematical result of addition or subtraction of columns or rows of numbers in documents or records.
6. **Re-compute:** To check mathematical computations performed by others.
7. **Reconcile:** The process of matching two independent sets of records and to show mathematically, with supporting documentation, the difference between the two records. For example, the beginning and ending balances in an account could be reconciled to document the transactions that account for the changes between the beginning and the end.
8. **Confirm:** To obtain information from an independent source (third party) for the purpose of verifying information.
9. **Vouch:** To verify recorded transactions or amounts by examining supporting documents. In vouching, the direction of testing is from the recorded item to supporting documentation. The purpose for vouching is to verify that recorded transactions represent actual transactions.
10. **Trace:** Tracing procedures begin with the original documents and are followed through the processing cycles into summary accounting records. In tracing, the direction of testing is from supporting documentation to the recorded item. The purpose of tracing is to verify that all actual transactions have been recorded.

B. OBSERVATION

Observation is auditors seeing with a purpose, making mental notes and using judgment to measure what they see against standards in their minds. Experienced auditors may be better able to observe deviations from the norm. Observed deviations usually require confirmation through analysis or corroboration.

C. INQUIRY

Auditors perform interviews with the auditee and related parties throughout the audit. Good oral communication skills on the part of the auditor assist in getting accurate and meaningful information from the interviewee. Auditors should use open-ended questions when possible. Depending on the type of information received in an interview, it may need to be confirmed through documentation.

D. ANALYSIS

Analysis is the separation of an entity for the purpose of studying the individual parts of data. The elements of the entity can be isolated, identified, quantified, and measured. The quantification may require the auditor to perform detailed calculations and computations. Furthermore, the auditor can document ratios and trends, make comparisons and isolate unusual transactions or conditions.

AUDIT SAMPLING GUIDELINES

DEFINITION OF AUDIT SAMPLING TERMS

Attribute: The qualitative characteristic of a population element. For example, the classification of vouchers as to whether or not they were properly signed. Sampling for attributes uses two-fold or binomial classifications: "yes" or "no."

Audit Sampling: The application of an audit procedure to less than 100 percent of the items within an account balance or class of transactions for the purpose of evaluating some characteristic of the balance or class.

Confidence Interval: A range of values for a sample statistic wherein the actual population value is believed to lie. The interval is computed on the basis of a known sample value, a desired precision and a specified level of confidence. For example, assume that the results of a 95% confidence level sample produce a confidence interval whereby the lower confidence limit is \$150 and the upper confidence limit is \$325. This means that if the auditor were to repeatedly draw random samples of a certain size (e.g., several samples of 80 items) and calculate the confidence interval at the 95% level, then about 95% of the intervals would be expected to encompass the actual population value.

Confidence Level or Degree of Assurance: The confidence level indicates the degree of assurance (probability) that the results of a sample are reasonable estimates of specific population characteristics. Confidence levels are usually expressed in percentages such as 90 or 95 per cent. A 95% confidence level means that if repeated samples were selected, the actual value would fall within the confidence intervals about 95% of the time.

Frequency Distribution: The classification of numerical data according to size or magnitude (how many or how much). A population whose elements are classified according to some quantitative characteristic (e.g., dollar values of purchase order, of invoices, etc) may be described by a frequency distribution. A symmetrical distribution is a frequency distribution that can be portrayed by a normal (bell) curve. A skewed distribution is a frequency distribution which extends further in one direction than in another. An example of a skewed distribution would be one that involved 500 invoices totaling \$1,000,000 with 5 of the invoices amounting to \$100,000 each. By examining all the high-value invoices, and thereby removing them from the skewed distribution, the remaining invoices, assuming no further extremes, would reflect a normal distribution lending itself to random sampling.

Mean: The sum of the population values divided by the number of items in the population. Thus, if the population consists of 7 accounts with balances of \$3, \$6, \$7, \$10, \$13, \$14 and \$17, the mean would be \$10 ($\$70/7$). The mean is also called the arithmetic mean and the average.

AUDIT SAMPLING GUIDELINES

DEFINITION OF AUDIT SAMPLING TERMS CONT.

Median: A central value which divides an array of a set of data (numerically ordered by magnitude) so that one half of the items are the same as or larger than it, and one half of the items are the same as or smaller than it.

Mode: The value which occurs most frequently in a set of data. For a set in which each value occurs only once, there is no mode. In another set of data, there may be more than one mode when two values occur the same number of times and are the most frequent.

Non-sampling Risk: Results from uncertainties that are not due to sampling. For example: (1) Incorrect audit procedures for a given objective or (2) Non-recognition of errors.

Population: Also known as **Universe** or **Field**. The aggregate or entirety of the items or units about which information is desired. The population excludes individually significant items that the auditor has decided to test 100 percent or other items that will be tested separately. For sample results to be reliable, the sample must be selected from the complete population.

Precision: The range within which the estimate of the population value or characteristics will fall at the confidence level. It is a range or tolerance and is usually expressed as a plus-or minus percentage, such as +/- 3 percent, or as an amount, such as +/- \$1,000. For example, an auditor may conclude that there is a 90 percent probability, or confidence, that the average value of an account is within \$50, either way of the sample average of \$700. In turn, there is a 10 percent risk that the average value is greater than \$750, or less than \$650.

Probability: The ratio of the frequency of certain events to the frequency of all the possible events in a series or set. In other words, the number of times that something can occur in a specific way, as compared with the number of times it can happen in all possible ways. This is usually expressed as a decimal ratio which can be converted to a percentage by multiplying by 100.

Sampling Risk: Results from the possibility that if a test is restricted to a sample, the conclusions reached may be different than the conclusions that may result if the entire population is examined.

Standard Deviation: Measures the degree to which individual values in a list vary from the mean (average) of all values in the list. The lower the standard deviation, the less individual values vary from the mean, and the more reliable the mean. A standard deviation of 0 indicates that all values in the list are equal. To obtain the standard deviation, one must calculate the difference between the value of each individual item in the population and the population mean, square these differences, add them, divide the sum by the total number of items, and finally extract the square root.

AUDIT SAMPLING GUIDELINES

DEFINITION OF AUDIT SAMPLING TERMS CONT.

Variability: A measure designed to describe the scatter or dispersion of a Frequency Distribution.

Variable: A quantitative characteristic of a elements (items) of a population which may vary from the observation of one item to another.

Variance: The square of the standard deviation.

STATISTICAL & NON-STATISTICAL SAMPLING GUIDELINES

STATISTICAL SAMPLING

Statistical sampling is based on the assumption that, within a given confidence (assurance) level and allowance for sampling risk, a randomly selected sample of items from a population will reflect the same characteristics that occur in the population. Therefore, auditors may draw valid conclusions based on data derived from a relatively small sample of the total population. Statistical sampling allows the auditor to provide a mathematical measurement of the degree of uncertainty that results from examining only part of the population.

Following is a description of attributes and variables sampling plans with recommended use of those plans. The auditor may apply both plans to the same sample selected.

A. Attributes Sampling

Recommended Use: To estimate the qualitative characteristics of a population obtaining "yes or no" answers with a measurable degree of reliability.

In attributes sampling, the auditor tests a sample for qualitative characteristics; the answer is either "yes" or "no".

B. Variables Sampling

Recommended Use: To estimate the quantitative characteristic of a population (i.e., dollars, time spans, weights, or other quantitative characteristics) with a measurable degree of reliability.

In variables sampling, the auditor tests a sample to estimate the quantitative characteristics of a population. The following general steps are followed in variables sampling.

STATISTICAL SAMPLE SELECTION METHODS

The following is a list of five statistical sample selection methods available to the auditor with the recommended use for each of the sample selection methods:

A. Stratified Sampling:

Recommended Use: When the population is composed of items which vary significantly in size, either amount or characteristic.

An auditor should attempt to identify wide variations in size, either in amount or characteristic of items making up a population. If wide variations are present, the auditor should consider stratified sampling. Using this method, the auditor first segregates the population into two or more distinct, sub-populations called stratum. The largest, or most expensive, or most significant items in a population can either be 100% examined if the total sub-population is defined small enough, or it can be examined by a separate random sample. A separate random sample is made of each of the remaining stratum. Unless the sub-

STATISTICAL AND NON-STATISCAL AUDIT SAMPLING GUIDELINES

population is to be sampled 100%, the sample size from each stratum should be at least 30, in order to avoid problems with precision calculation. The results of the several samplings from each of the different stratum may then be combined into an overall estimate for the entire population.

B. Random Number Sampling:

Recommended Use: Where each of the items in the population is or can be easily numbered.

The auditor selects a random sample by matching random numbers generated by a computer or selected from a random number table with, for example, the document number. With this method, every item in the population has the same probability of being selected as every other item in the population. In a stratified population, where some of the stratum are sampled with greater intensity than others, each item in the entire population does not necessarily have an equal chance of selection.

C. Interval Sampling:

Recommended Use: Where items are not or cannot be easily numbered.

A method by which items are selected from the population in such a way that there is a uniform interval between sample items. The first item in the series must be chose at random and then every "n"th item is chosen to result in the desired sample size.

D. Cluster Sampling:

Recommended Use: When a population is so dispersed that interval sampling or unrestricted random number sampling would be burdensome.

Cluster sampling is the method of sampling whereby the population is formed into groups or "clusters" of items. The first step is to make a random selection of clusters to include in the sample. Then the items within the selected clusters may be randomly selected and sampled. This is called Multi-stage Sampling. For example, in surveying a large number of tool cribs, audit expense may be reduced by the use of cluster sampling: First, a random selection is made of the cribs, and then a random selection is made of the tool records within the cribs that were randomly selected. Cluster Sampling is commonly used to get the most precise results from a fixed budget, however it is not as precise as Random Sampling.

STATISTICAL AND NON-STATISTICAL SAMPLING GUIDELINES

E. Computer Sampling:

Recommended Use: When the population is, or easily can be, recorded on disk, magnetic tape or other machine media.

Computer-assisted sampling can be divided into two general areas:

1. Using either spreadsheet or audit software with either hardcopy or computer media (e.g., disk)
2. Using audit software, such as ACL (available in the City Auditor's Office).

NONSTATISTICAL SAMPLE SELECTION METHOD

Non-statistical sampling does not allow the auditor to extrapolate findings to the entire population. It does allow the auditor, to make positive or negative statements about specific items in the population. (NOTE: SAS No. 39 allows the auditor to use non-statistical sampling in performing tests of controls.)

The following is the non-statistical sample selection method available to the auditor with recommended use for the method.

F. Judgment Sampling:

Recommended Use: To use samples for the purpose of obtaining information that need not be attributed to the entire population with measured reliability.

The selection of those items which in the judgment of the auditor best suits the audit objective. The degree to which the judgment sample represents the population cannot be demonstrated mathematically. It therefore, should not be used as representative of the population.

Judgment sampling may be used to select examples of deficiencies to support the auditor's contention that the system is weak. It may also be use to make a directed search for defective items to confirm or support the auditor's belief that the system is not properly identifying defective items.

Judgment sampling may also be used to document that a system of internal controls is functioning properly and that a statistical sample is not necessary.

AUDIT EVIDENCE GUIDELINES

OBJECTIVE

Evidence obtained by the auditor should meet the basic tests of sufficiency, relevance, and competence. In addition, the information resulting from audit evidence should be useful. The working papers should reflect the details of the evidence and disclose how it was obtained.

- A. Sufficiency** -- Sufficiency is the presence of enough factual and convincing evidence to support the auditors' findings, conclusions, and recommendations. Determining the sufficiency of evidence requires judgment; however, a prudent, informed person should be able to reach the same conclusions as the auditor. When appropriate, statistical methods may be used to establish sufficiency.
- B. Relevance** -- Relevance refers to the relationship of evidence to its use that is consistent with the audit objectives. The information used to prove or disprove an issue is relevant if it has a logical, sensible relationship to that issue. Information that does not is irrelevant and therefore should not be included as evidence to support audit findings and recommendations.
- C. Competence** -- To be competent, evidence should be valid and reliable. In evaluating the competence of evidence, the auditors should carefully consider whether reasons exist to doubt its validity or completeness. If so, the auditors should obtain additional evidence or disclose the situation in the audit report.

Usefulness -- Useful information helps the audit staff meet its audit objectives.

CATEGORIES OF AUDIT EVIDENCE

Audit Evidence is categorized as follows: physical; documentary, testimonial; and analytical.

- A. Physical evidence** -- Physical evidence is obtained by direct inspection or observation of (a) activities of people, (b) property, or (c) events. Such evidence may be documented in the form of:
 - a. Memoranda summarizing the matters inspected or observed;
 - b. Photographs;
 - c. Charts;
 - d. Maps; and
 - e. Actual samples.

AUDIT EVIDENCE GUIDELINES

B. Documentary evidence -- Documentary evidence consists of created information. The documents, forms, journals or reports may originate within the auditee organization or may come from an external source. Examples are:

- a. Letters;
- b. Contracts;
- c. Laws;
- d. Regulations;
- e. Procedures;
- f. Budget information;
- g. Accounting records; and
- h. Management Information on Performance.

C. Testimonial evidence -- Testimonial evidence is obtained from others through statements received in response to inquiries or through interviews. Statements important to the audit should be corroborated when possible with additional evidence. Testimonial evidence also needs to be evaluated from the standpoint of whether the individual may be biased or only have partial knowledge about the area.

D. Analytical evidence -- Analytical evidence is the result of analysis and verification. Some of the techniques used to produce analytical evidence are:

- a. computations;
- b. comparisons;
- c. reasoning; and
- d. separation of information into components.

AUDIT SERVICES REQUEST GUIDELINES

PURPOSE

To establish the procedure for submission and approval of City Auditor services which are outside the scope of the Office's approved workplan.

GENERAL

- A. In advance of each fiscal year, the City Auditor submits to the Audit Committee a proposed Annual Audit Workplan. The formalized workplan is presented to the Board of Supervisors for final approval.

- B. The Board of Supervisors and City Management may submit requests for City Auditor services outside the formal workplan to the Audit Committee which will ultimately approve or disapprove of all requests for inclusion in the workplan.

PROCEDURE

- A. City Auditor
 - 1. Upon receipt from the Audit Committee, reviews and evaluates outside requests for audit services based on availability of resources, external time constraints and office priorities. Advises the Audit Committee accordingly.

 - 2. Upon Audit Committee approval, initiates the audit assignment as soon as time is available or priorities have been adjusted accordingly.

 - 3. Reports monthly to the Audit Committee and quarterly to the Board of Supervisors on the status of approved audit assignments.

 - 4. In emergency situations, may respond immediately to requests from the Mayor, Board of Supervisors, or City Manager.

 - 5. In the case of an emergency request, reports to the Audit Committee at its next meeting the following information:
 - a. Any requests for immediate response received
 - b. What action was taken
 - c. The disposition of the request

- B. Outside Requestors
 - 1. Submit Auditor services requests to the Audit Committee for consideration

 - 2. Receives notification from the City Auditor as to the status of their request.

AUDIT SERVICES REQUEST GUIDELINES

C. Audit Committee

1. Forwards service requests to the City Auditor for review and evaluation.
2. Upon receipt of the Auditor's response, reviews the response and evaluates the services request in terms of suggested criteria and priority.
3. Approves/disapproves the requested assignment and communicates the decision to the City Auditor, Board of Supervisors and the service requestor.
4. Receives from the City Auditor a monthly status report on approved outside audit assignments.

WORKPAPER PREPARATION

WORKING PAPER PREPARATION

A record of the work performed by the City Auditor shall be retained in the form of working papers. The working papers will serve as a record of the results of the audit and the basis of the opinions, findings, and recommendations of the auditor.

The working papers should be prepared based on a written audit program and contain sufficient information so that supplemental oral explanations are not required. The working papers should be legible with adequate indexing and cross-referencing, and include summaries and lead schedules as appropriate.

The working papers should contain only that information which is materially important and relevant to the objectives of the audit.

Each working paper should be initialed and dated by the City Auditor. The working paper should indicate the purpose of the working paper and the source of the information from which it was prepared. The auditor should reflect in the working papers a written conclusion for each major audit area.