

Limited Scope Audits and Assessments of Key Functions Across City Departments

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Audit Forum
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Presented by:
City Services Auditor,
Office of the Controller
City and County of
San Francisco





Presentation Description

This session will provide ideas on how to design a successful limited scope audit program using best practices that can be deployed across various key government processes to impact policy and improve operations.





Content

- City and County of San Francisco Overview
- Limited Scope Audits & Assessment Work Plan Development
- Examples: Cash Transactions Assessment, Payroll Limited Scope Audit, and Contract Limited Scope Audit
- Reporting Comparing Results: Full Scope Audits Audits vs. Limited Scope Audits
- Outlook



Presenter — TONIA LEDIJU



**Director of City Audits
Office of the Controller**

Professional Associations:

- City and County Management Association
- Western Intergovernmental Audit Forum
- The Institute of Internal Auditors (IIA)
- Association of Local Government Auditors.

Education:

- Master's degree, Leadership Saint Mary's College of CA
- Ph.D., Organizational Systems (*pursuing*)

In 2009 the City's Controller appointed Tonia as Director of City Audits. Tonia has 20+ years of leadership and government auditing experience. She previously served as audit director for various State of California agencies.

Tonia strives to provide the highest quality of service to the City and is committed to accountability, excellence, and transparency. "How can the Audits organization best serve the City with a viable audit program?" said Tonia. In meeting this challenge, robust and risk-based audit programs were developed pertaining to the City's key business processes and activities, resulting in successful collaboration and overall positive feedback from City management and leaders.

Under her leadership, the Audits Unit was awarded a Gold Knighton Award, presented by ALGA, for an audit of Purchasing of Office Depot Office Supplies, which found that Office Depot overcharged the City at least \$5.75 million. Also, Tonia leads the City's efforts in cost recovery for disasters such as the 2013 Asiana plane crash at SFO and the Rim fire in the central Sierra Nevada region.

Tonia's leadership philosophy is service through integrity, teamwork and collaboration, respect, and inclusion. Through this she has built a high-functioning audit organization.



Presenter — IRELLA BLACKWOOD



Lead Audit Manager
Office of the Controller

Irella has been with the City and County of San Francisco since 2010. Irella heads the Citywide Audit Program, which covers more than 54 departments and agencies. This includes leading a variety of reviews, audits, assessments, and unique performance audits to measure the economy, efficiency, compliance, and effectiveness of federal, state, and local government resources. She leads her team with a balanced approach that considers costs and emphasizes relationship building while making decisions that yield innovative results. Irella is adept at managing teams of varied levels of expertise and promotes a collaborative team environment.

Irella has built successful teams to accomplish meaningful deliverables. Under her leadership, a number of projects gained significant press coverage, including the low-income assistance program assessment of the City's Public Utilities Commission, the payroll audit of the Fire Department, and a financial management review of the Arts Commission.

Before joining the City, Irella worked for PricewaterhouseCoopers LLP (PwC) where she conducted internal control (SOX), financial, and IT audits for technology companies in Silicon Valley, such as eBay and Cisco Systems. She has also held a key role in the regulatory department of a Fortune 200 company. She has a B.A. in Economics from the University of California, Berkeley, and an M.B.A in Finance from Holy Names University.



Presenter — KATE CHALK



Audit Manager
Office of the Controller

Kate has been with the City and County of San Francisco since 2010. Kate is a manager with the Citywide Audit Program and leads audits and assessments that promote the efficiency and effectiveness of City government. Kate has lead or worked on a variety of audits across many of the City's 54 departments or agencies including compliance audits of inventory, purchasing, cash handling, and contracts, and larger performance audits of parking enforcement and asset management.

Kate also leads the unit's payroll audit program, which includes individual departmental audits and citywide payroll testing. In fiscal year 2013-14, salaries and fringe benefits were more than half of the City's expenditures. The payroll audits have identified numerous overpayments, underpayments, missing controls, system issues, and incorrect payroll practices.

Before joining the City, Kate worked for PricewaterhouseCoopers LLP (PwC) where she performed financial audits for a broad range of private companies, including wineries, manufacturers, venture capital firms, and tech companies, all across the Bay Area. She has two B.S. degrees, one in Business and one in Accounting, from the University of Southern California. Fight on!



CITY AND COUNTY OF SAN FRANCISCO ORGANIZATIONAL STRUCTURE



The City and County of San Francisco is the only consolidated city-county in California and the second most densely populated city in the United States. Its annual operating budget is \$7.9 billion.

(As of June 30, 2013)

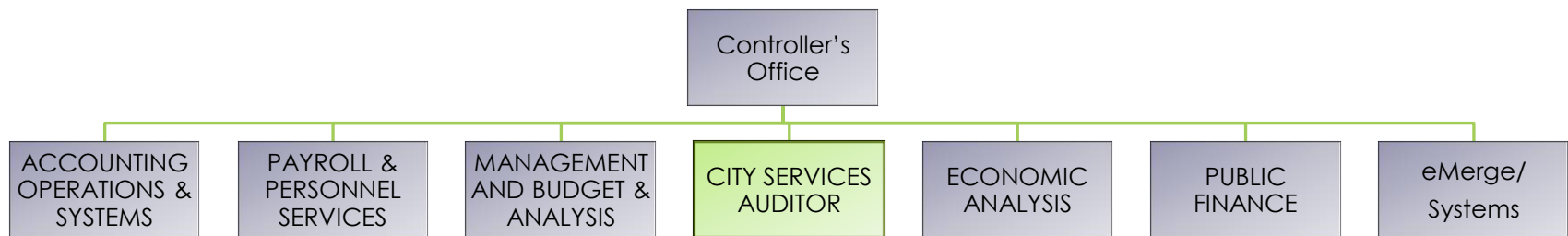




Office of the Controller

The Controller is independent, being appointed by the Mayor and confirmed by the Board of Supervisors for a ten-year term. The Office of the Controller's mission is to ensure the City's financial integrity and promote efficient, effective, and accountable government.

The Office of the Controller's vision is to strive to be a model for good governance and to make the City a better place.





City Services Auditor Division's Mission

The City Services Auditor (CSA) is the auditing branch of the Office of the Controller. The Division conducts performance and financial audits of city operations and makes recommendations to improve the efficiency and effectiveness of city departments, agencies, office, and functions, and contractors and nonprofits that receive city funding. The Division's responsibilities align with the city Charter.

The Division also maintains a whistleblower complaints hotline and Web site and conducts investigations regarding waste, fraud, and abuse of city resources.





CSA Operating Budget

- Two-tenths of one percent (\$15.3 million) of the City's operating budget is dedicated through Charter Appendix F.
- In the fulfillment of Charter responsibilities, CSA has 42 full-time staff to cover 54 departments and agencies.

CITY SERVICES AUDITOR	
FY14-15 Budget	
Department or Fund	Budget
General Fund	\$ 3,765,287
Municipal Transportation Agency	1,900,725
Public Health: General Hospital	1,723,716
Public Health: Community Health Service	1,681,072
Human Services	1,572,969
Airport	1,402,693
Public Utilities Commission	972,179
Public Health: Laguna Honda Hospital	453,209
Child, Youth, Family	312,975
Recreation and Parks	307,052
Public Works	297,232
Library	216,984
Building Inspection	200,236
Port	195,764
Children and Families Commission	98,323
Retirement System	55,883
Environment	31,103
War Memorial	27,562
Child Support Services	25,883
Rent Arbitration Board	13,061
Department of Technology	10,938
Total	\$ 15,264,846



Why CSA created Program Audits

Formerly, the City and County of San Francisco did not centrally monitor risks related to:

- Cash-handling
- Contracts
- Payroll
- Inventory
- Cash Disbursements



Because of a lack of citywide policies and procedures, CSA developed various limited scope audits and assessments to improve the control environment.



Selecting a Function

The limited scope audits and assessments work plan is developed based on an identification and prioritization of critical functions. Critical functions are identified through impact on:

1. Budget
2. Materiality
3. Fiscal responsibility
4. Audit capacity
5. Overall risk
6. Stakeholder Input





Developing the Audit Program

The following process was used to develop the program in San Francisco:

1. Stakeholder Input
2. Select key areas of review
3. Assess resources
4. Research and identify relevant laws and best practices (benchmarking)
5. Develop surveys
6. Establish objectives
7. Develop templates

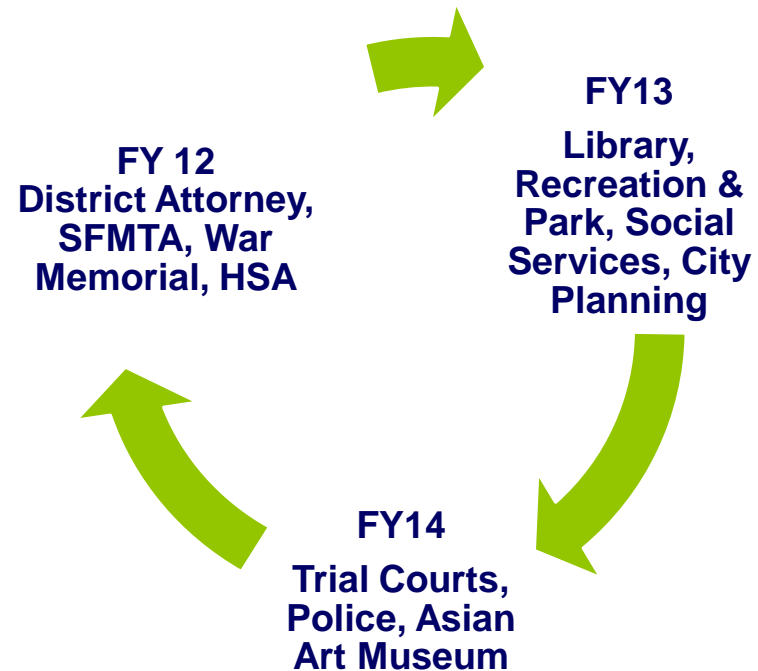




Planning the Audit Schedule

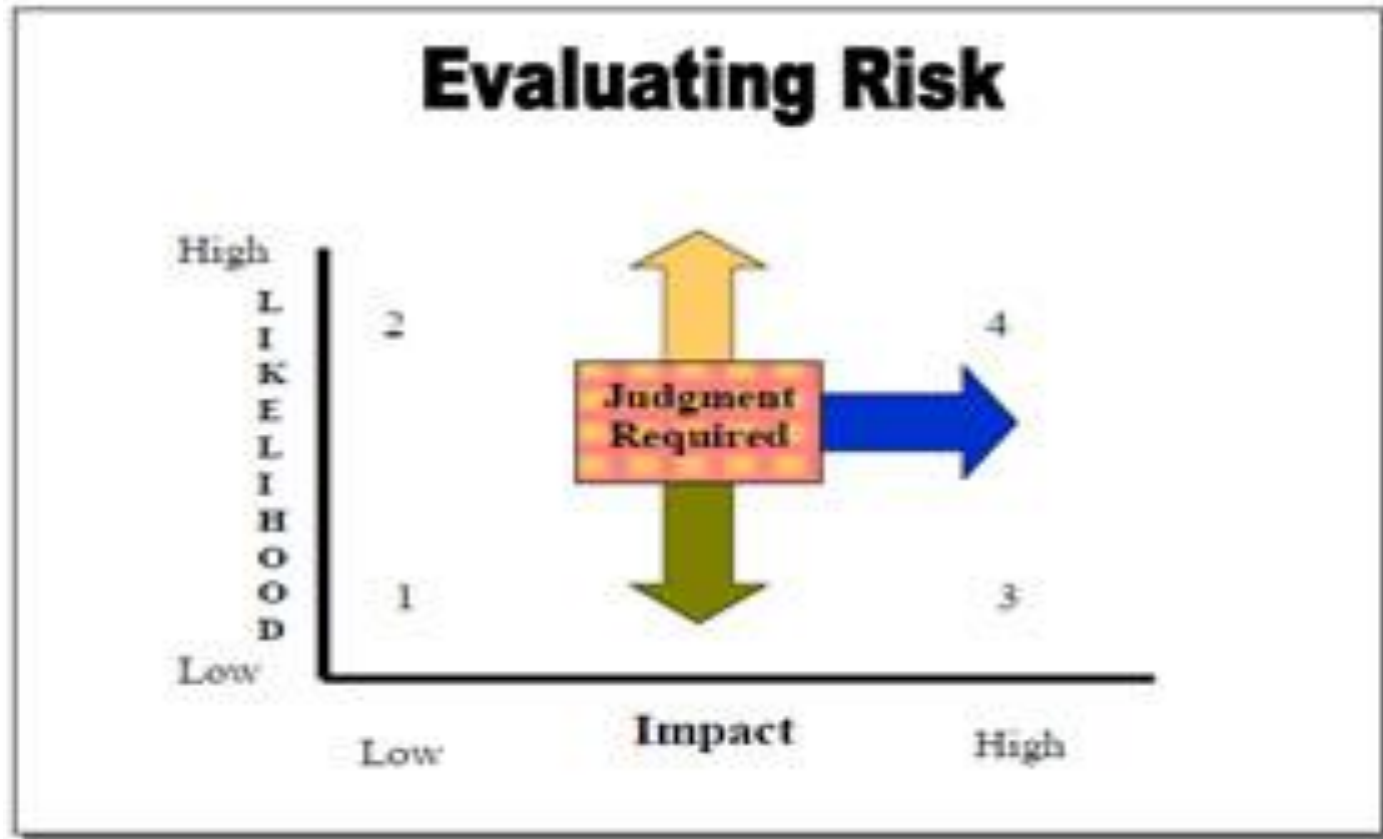
The following process was used to plan the audit schedule:

- Collect and analyze program data.
- Assign risk scores to each area.
- Identify departments to further examine on a rotating basis.
- Plan rotating schedule to ensure audit coverage.



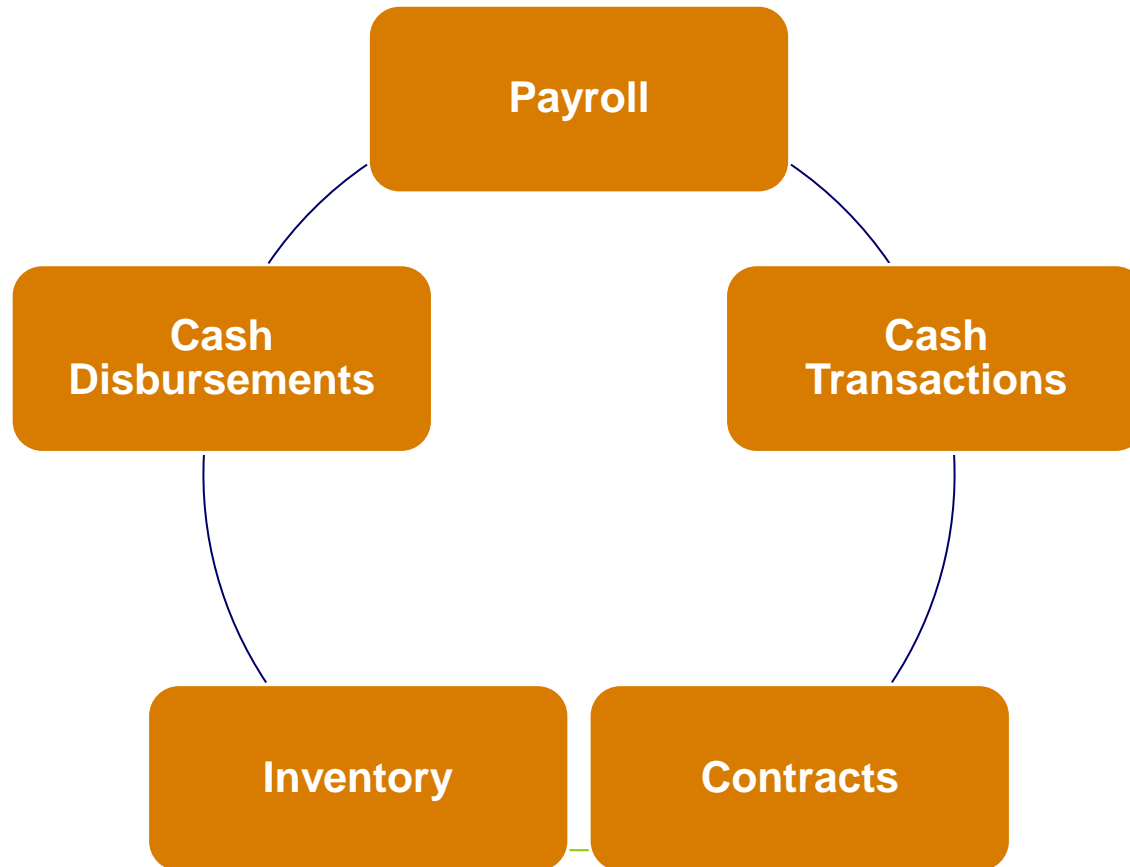


Selecting the Most Relevant Areas: *Constantly Prioritize Risks!*





Critical Areas of Focus





Citywide Limited-Scope Audits & Assessments:

Audit Objectives

- **Payroll Audits** – Assess whether departments accurately paid certain premium pays, complied with eligibility provisions or labor agreements for the premium pay, and used adequate and effective internal controls in the pay process.
- **Cash Disbursements** – Assess the adequacy of departments' internal control structure and whether cash disbursements are made in accordance with governing policies and procedures while adequately safeguarding the City's resources. (Departments have the authority to directly purchase commodities and services valued at \$10,000 or less.)
- **Cash Transactions** – Assess the adequacy of cash-handling processes and controls. The assessments determine whether departments have effective controls to accurately collect and safeguard cash and properly and promptly deposit the cash they receive.
- **Inventory Audits** – Assess inventory processes and controls. Also, ensure that materials, supplies, and tools are accurately accounted for, adequately organized, and properly secured.
- **Contract Audits** – Assess whether departments and contractors have complied with contract terms and provisions.





Budget & Timeline Development

Type	Universe	Number Performed per Year	Budgeted Hours per Project	Timeline	% of Audit Work plan
Cash Transactions Assessments	337 Locations	10	100	3 months 1 st – 4 th Qtr.	4%
Payroll Limited-Scope Audits	54 Departments	3	300	3 months 1 st – 4 th Qtr.	3%
Contracts Limited-Scope Audits	1,800	2	250	3 months 1 st – 4 th Qtr.	2%
Inventory Limited-Scope Audits	5 Departments	3	150	3 months 1 st – 4 th Qtr.	2%
Cash Disbursements Assessments	54 Departments	4	150	3 months 1 st – 4 th Qtr.	2%



Develop Standard Templates

Design templates for your teams, including:

- Internal Control Narratives (resulting from walk-throughs)
- Procedural steps
- Memorandums
- Segregation of duties matrix
- Enhance and further develop as necessary





Designing Your Team

In creating a team, design it to best meet the particular needs of your organization. Some things to consider in developing a team:

- Budget
- Team structure *(be comfortable with pulling team members in and out of the project)*
- Supervision
- Roles and responsibilities
- Skill sets
- Monitor team structure
- Remove barriers when necessary
- Measure results



For example: A Cash Transactions Assessment team may consist of several auditors performing various steps within the process (planning, fieldwork, reporting writing). Audit teams have 100 hours each to complete the assessment within 3 months (quarter). This includes 65 hours for auditors and 35 hours for supervisor and quality assurance and independent review. The templates, procedures, and team structure provide for consistency of work and timely completion of projects.



Example 1 – *Cash Transaction Assessments*

The Cash Transaction Assessment program was implemented in 2010 to assess and monitor internal controls needed in a good cash-handling system: segregation of duties, security, reconciliation, management review, and documentation.

We identified 54 city departments that collect cash and then surveyed each department. 47 of the 54 departments responded to the survey and reported 337 cash collection points.



- 31 departments (66 percent) reported multiple cash collection points, ranging from 2 to 41 points of collection.
- 16 departments (34 percent) reported 1 cash collection point.
- 7 departments did not respond to the survey.



Cash Transaction Assessments:

Select the Most Relevant Areas

We selected the following risk assessment criteria to consider in our ongoing monitoring of San Francisco's cash transactions:

Criteria	Description
Monthly dollar amount of transactions	The value of a department's monthly collections. The higher the value, the higher the perceived risk.
Daily frequency of transactions	The number of transactions in the department per day. The more transactions, the higher the perceived risk.
Reconciliation variances	Differences between expected and recorded revenue amounts, if any. The greater the difference, the higher the perceived risk.
Collection complexity	City departments use different methods to collect cash, and a department may use more than one method. The more methods used, the higher the perceived risk.
Extent of centralization	The design and number of departments' cash collection points vary. The more locations, the higher the perceived risk.
Survey signals	Some departments' answers to the survey questions indicated potential internal control weakness that required follow-up inquiry and investigation. The more answers, the higher the perceived risk.



Cash Transaction Assessments:

Most Relevant Areas

Cash Transaction Risk Areas and Risks Identified

- **Collections**

- How is cash received. Mail or in person?
- Who is responsible for collecting cash and recording cash.
- **Risk:** Cash is received by inappropriate staff or segregation of duties is not in place.

- **Security of Cash**

- How is the cash secured?
- Is the key kept in a secure area?
- **Risk:** Inadequate security of cash.



- **Balancing**

- Cash receipts must be balanced every day.
- The cash, checks, credit card receipts, etc. must be compared to the cash register total or pre-numbered receipts.
- Discrepancies must be resolved.
- Proper segregation of duties must exist.
- **Risk:** Large discrepancies.



Cash Transaction Assessments:

Most Relevant Areas (continued)

Cash Transaction Risk Areas and Risks Identified

- **Deposits**
 - Who prepares the deposits and how?
 - Deposits should be made daily.
 - **Risk:** Money collected is used for purchases or for cashing checks.
- **Reconciliation**
 - Cash reconciliation must be done by a person with no cash-handling responsibilities.
 - **Risk:** inadequate segregation of duties, proper documentation of review not maintained.
- **Management Review**
 - Payroll and departmental human resources data disagree, resulting in incorrect payments based on inaccurate leave status.
 - **Risk:** Theft and misappropriation of cash.



Cash Transaction Assessments:

Internal Control Questionnaire



Some questions we ask:

1. Are written policies and procedures in place?
 - Do written procedures accurately reflect all current practices?
 - Is training on cash-handling policies and procedures provided to all employees who handle cash?
 - Is cash-handling training completed annually and is the training fully documented.
2. Are all the following duties generally performed by different people?
 - Collection of cash
 - Preparation of deposit slips
 - Maintenance of mail receipts log
 - Reconciliations (for example, cash collection records to City's accounting system and to bank statements, as applicable)



Cash Transaction Assessments:

Internal Control Questionnaire (continued)



4. Are receipts provided for all cash collected?
5. What types of receipts are provided to customers?
 - Cash register receipt
 - Pre-numbered receipt book
 - Tickets or passes
 - Other, please describe
6. Are all cash receipts deposited daily (currency, checks, and credit card)?
7. How is cash physically safeguarded against theft?
 - Locked drawer
 - Locked safe
 - Security camera
 - Other, please describe
8. Are register/computer users assigned unique log-ins/passwords?
9. Does management have knowledge of any fraud or suspected fraud related to cash receipts in the current or prior two fiscal years?



Example 2 – Payroll Audits

Personnel expenses are more than half of the City's total budgeted expenses. The payroll audit program started in 2011 to provide reasonable assurance that departments have adequate and effective controls to ascertain the integrity of pay transactions and to assess whether procedures are in place and operating as intended. We identified 54 city departments with payroll functions.





Payroll Audits:

Limited-Scope Audit Program Development - *Central Planning Efforts*

Partners in the Payroll Process





Payroll Audits:

Select the Most Relevant Areas

Payroll Risk Areas and Risks Identified



Special pays

- Special pays are paid inaccurately.
- Employees are ineligible for the special pay.
- Top special pays are paid inefficiently.

Manual time entries

- Employees are paid for hours that were not recorded.
- Employees are paid with the wrong pay code.
- Symbol changes (adjusting previous time entries from one pay code to another) cause higher costs to the department.
- Rate adjustments are incorrect or invalid.

Wage rate accuracy

- Employee wage rates are not accurately or promptly updated to reflect changes in job position and step.

Internal controls

- Processes and controls (such as segregation of duties and time entry) are weak.
- Pay advice (including for manual checks) is not accurately or promptly distributed.
- Timesheets are not properly approved.



Payroll Audits:

Select the Most Relevant Areas (continued)

Payroll Risk Areas and Risks Identified

- **Position at retirement**
 - Retiree's lump sum payout is calculated using a rate inconsistent with labor agreement or Retirement System's requirements.
- **Temporary employees**
 - Temporary employees receive inaccurate pay amounts.
 - Temporary employees are ineligible for pay.
- **Employee leave status**
 - Payroll and departmental human resources data disagree, resulting in incorrect payments based on inaccurate leave status.
- **Payouts to retired or separated employees**
 - Discrepancies regarding separated employees exist among the employee's department, Department of Human Resources, Retirement System, and/or Controller's Payroll and Personnel Services Division.
 - Lump-sum payouts are not paid in a timely manner.



Payroll Audits: Payroll Survey Questionnaire

Questionnaire consists of 24 questions, including:

1. Does the department have its own time entry system that interfaces with PeopleSoft? If yes, please include the name of your system in the "Comments" box.
2. Who inputs time to PeopleSoft or the department's timekeeping system? How often?
3. What percentage of time entries and associated documents are reviewed by the department's payroll supervisor?
4. Does the department monitor, reconcile, and routinely audit PeopleSoft pay reports?
5. Are confidential payroll records and reports, including payroll change forms (problem description forms), safeguarded in a locked area accessible only by authorized personnel?



Payroll Audits:

Payroll Survey Questionnaire (continued)

6. Does the department have written procedures for reviewing and managing employee disability benefits?
7. How does the department ensure that an employee receives the appropriate step increase? Please explain.
8. Are overtime hours, compensatory time, altered work schedules, and other similar work time approved before the hours are worked? If so, how?
9. Before premium pays are paid to an employee, does payroll verify that the employee is eligible for the premium pay? Do you maintain supporting documentation to support the premium pay?
10. Does the department monitor other pays such as acting assignment pay, supervisory differential pay, police motorcycle pay? If yes, how often (e.g., biweekly, monthly, quarterly)?



Payroll Audits: Citywide Testing

Under the payroll audit program, CSA now also performs citywide payroll tests to increase the “touches” we make across the 54 city departments.

FY 12-13 Approach:

- Test manual pay rate changes for five months of payroll data

FY 13-14 Approach:

- Administer citywide payroll control survey
- Test “unusual” paycheck fluctuations between two pay periods.

Citywide communication:

- Citywide payroll audit notification letter, scope and objectives statement, etc.

Key lessons learned:

- Target data wisely
- Target by job classification to limit the criteria (MOUs) impacting the payroll testing.



Example 3 - Contracts

Limited Scope Audits

Risks of Contracting

- Of the \$1.8 billion budgeted for non-labor operating expenses, San Francisco will spend the majority through contracts in 2013-14.
- Risk is inherent to each phase of the contracting process.
- Risks from procurement through contract award:
 - Finding qualified vendors to provide commodities/services
 - Defining specifications
 - Securing a fair price
 - Writing a contract that is sufficient to protect the City
- Risks after contract is awarded:
 - Vendor compliance
 - Performance
 - Billing

So...Contract Audits to Mitigate Risks

Began a series of contract compliance audits in 2011-12.





Contract Audits:

Select the Most Relevant Area

Contract Risk Areas and Risks identified:

- Types of goods or services
- Complexity of contract type
- Contract amount
- Contract term
- Number of departments using the contract
- Contractor is paid using Automated Clearing House (ACH)
- Number of Whistleblower complaints in the last five years
- Pricing structure (fixed price, cost reimbursable)
- Written policies and procedures
- Sole source contract
- Some Risks:
 - Activities are not performed.
 - Improper payments (fraud, waste, and abuse)
 - No oversight





Reporting

Effectively communicating results is a key element of this program. A strategic approach allows us to communicate findings in a focused manner. When designing a program, determine the type of reporting that best fits your organization. Some examples include:

- Continuously issue small reports
- Issue all reports at once, simultaneously
- Combined approach – a series of small reports followed by a combined (e.g., annual) report that groups findings by theme
- Confidential versus public or both





Summarizing the Results

Example – Tier-Grading System

Create a tier-grading system to enhance the ability to summarize and identify areas of concern. Examples:

Payroll

EXHIBIT 7 CSA Rankings of Audited Departments' Payroll Operations in Fiscal Year 2012-13			
	DEPARTMENT		
	Airport	Medical Examiner	Recreation and Park
Effective			
Some Improvement Needed	✓	✓	✓
Major Improvement Needed			
Unsatisfactory			

Source: Auditor analysis.

Cash Transactions Program

EXHIBIT 3 Cash-Handling Tier Grading by Department/Division				
Department	Effective	Some Improvement Needed	Major Improvement Needed	Unsatisfactory
Airport Commission	-	✓	-	-
Asian Art Museum	-	✓	-	-
Board of Supervisors	-	-	✓	-
Child Support Services	-	✓	-	-
City Attorney	-	✓	-	-
Fire Department	-	✓	-	-
Laguna Honda Hospital, Cafeteria	-	✓	-	-
Laguna Honda Hospital, General Store	-	-	✓	-
Office of Vital Records	-	✓	-	-

Source: CSA's determination.



Report Type

Audit or Assessment Type	Report Type
Cash Transactions Assessment	Annual Combined Public Report
Payroll: Limited-Scope Audit	Public report Annual Combined Public Report
Contract: Limited-Scope Audit	Public reports Annual Combined Public Report
Inventory: Limited-Scope Audit	Public report Annual Combined Public Report
Cash Disbursements Assessment	Public memorandums Annual Combined Public Report





San Francisco's Published Program Reports

- Recent combined cash transactions report:
<http://sfcontroller.org/Modules/ShowDocument.aspx?documentid=4827>
- Recent combined payroll report:
<http://sfcontroller.org/Modules/ShowDocument.aspx?documentid=4798>
- Contracts program report examples:
<http://sfcontroller.org/Modules/ShowDocument.aspx?documentid=5058>
<http://sfcontroller.org/Modules/ShowDocument.aspx?documentid=5144>
- Coming soon: cash disbursements and inventory audits*



Areas Covered

Function	Year Started	Universe	Coverage	
			Number	Percent
Payroll	2011	54 departments	10 departments	18%
Cash Transactions	2010	337 cash collection points	28 cash collection points	8% of cash collection points (this represents 44% of departments)
Contracts	2012	1,800 contracts	12 contracts	>1% of contracts*
Inventory	2014	5 departments	2 departments	40%
Cash disbursements	2014	55 departments	4 departments	7%

* Term-contracts



Comparing Results:

Full-Scope vs. Limited-Scope Audits

Compare:	<u>Full Scope Payroll Audit</u> <i>Fire Department</i>	<u>Limited Scope Payroll Audit</u> <i>San Francisco Airport</i>
Staff Hours	1,185	291
Audit Period	1 year	1 quarter
Timeline	6 months	3 months
Objectives	<ol style="list-style-type: none"> 1. Evaluate the accuracy of retirement disbursements. 2. Evaluate the accuracy of selected pay premiums and designations for positions. Premiums included: a) hazardous materials and b) training and education achievement. Designations for positions included short-term and long-term acting assignments. 3. Evaluate the adequacy of the design of the payroll system with respect to MOUs. 	<ol style="list-style-type: none"> 1. Verify the accuracy of the amount the Airport paid in multiple licenses pay for the third quarter of fiscal year 2011-12. 2. Assess whether the department complied with the applicable MOU in determining employees' eligibility for multiple licenses pay. 3. Determine whether the department adequately and effectively controls the payroll process. 4. Verify the accuracy and the proper approval of overtime pay and shift premium pay.
Results	<ol style="list-style-type: none"> 1. Higher-than-required wage rates for some employees. 2. Unofficial vacation accrual limits to calculate employee retirement distributions. 3. Inadequate payroll system caused both underpayments and overpayments to staff. 4. Most pay codes were not being used. 	<ol style="list-style-type: none"> 1. Ineligible employees received multiple licenses pay. 2. The licenses and certifications required to receive multiple licenses pay are not clearly documented. 3. Written policies and procedures for payroll processing can be strengthened. 4. Timesheets and overtime requests are signed without dates. 5. Some timesheets do not contain the hours of the day that the employee worked when shift pay was earned.



Limited-Scope Yet Effective!

- ✓ Limited-scope audits require significantly fewer hours to complete.
- ✓ Smaller audits allow the audit team to cover multiple areas in less time, thus demonstrating continuous progress.
- ✓ Results are similar to those of larger audits that require more hours (quality of audit is not sacrificed).
- ✓ Yellow Book – Assessments vs. Audits





Limited Scope Audits & Assessments

Results in Process Improvements

Citywide Policies and Procedures Established

- Accounting Operations Systems Division – Controller’s Office: Cash-Handling Guidelines
- Office of the Treasurer and Tax Collector: Banking Policy
- Payroll and Personnel Division: Central Pay and Personnel Policies
- Building Management Policies
- Training Programs

Other Process Improvement Areas

- City accounting system replacement
- Enhanced payroll and personnel and timekeeping practices
- Credibility of financial reporting
- Succession planning





On the Horizon





Value Added

- Focus on a few programmatic aspects or program objectives and assess areas of noncompliance or weaknesses.
- Focus on internal controls processes and transactions that may carry a greater risk profile
- Implement a rotation cycle
- Partner where necessary
- Keep in mind that a full-scope audit can be done later
- GAGAS 5.67 agreed-upon procedures engagements
- Constantly prioritize risks



Questions & Answers

