

# Agenda Report

February 1, 2016

**TO:** City Council  
**THROUGH:** Finance/Audit Committee (January 25, 2016)  
**FROM:** City Manager's Office, Internal Audit  
**SUBJECT: APPROVAL OF INTERNAL AUDIT FRAMEWORK**

**RECOMMENDATION:** It is recommended that the City Council:

1. Find that the proposed action is exempt from the California Environmental Quality Act (CEQA) pursuant to State CEQA Guidelines Section 15061(b)(3), the General Rule; and
2. Approve the internal audit framework as described below.

**RECOMMENDATION OF THE FINANCE/AUDIT COMMITTEE:** On January 25, 2016, the Finance/Audit Committee reviewed the Internal Audit framework and recommended that the City Council approve staff's recommendation.

**BACKGROUND:**

Having sound fiscal management policies and procedures are essential for any large organization to succeed in today's dynamic environment. Ensuring that funds are expended for intended purposes and within proper authorization lends trust that the organization is operating efficiently and effectively. One of the City Council's goals is to *Maintain Fiscal Responsibility and Stability*. This can only occur when there is an employee culture that understands and accepts accountability as a core value and a fundamental requirement to maintain the public trust.

In 2011, the Internal Audit position was eliminated as part of a budget reduction strategy and the Internal Auditor duties were transferred to the City Controller. Internal Audits continued to occur by private auditing firms. In 2014, management became aware of several instances where staff had not complied with financial policies. Audits presented to City Council were also identifying issues that needed to be addressed. These

examples demonstrated that the City was too large and complex to adequately manage an internal audit function with a part-time manager. In July 2014, as a measure of improving the City's fiscal management policies, City Council authorized a position for a new Internal Audit Manager.

The Internal Audit Manager was hired in November 2015 after an extensive search. The new Internal Audit Manager began to set up the Internal Audit function. Internal Audit is governed by Audit Standards and an Internal Audit Framework is required to define the requirements, including the Audit Standards and responsibilities for the Internal Auditor.

An Internal Audit Framework is a formal document that defines the Internal Audit activity's purpose, authority, and responsibility. An Internal Audit Framework establishes the Internal Audit activity's position within the organization, including the nature of the Internal Audit Manager's functional reporting relationship with City Council; it authorizes access to records, personnel, and physical properties relevant to the performance of engagements; and it defines the scope of Internal Audit activities. Final approval of the Internal Audit Framework resides with the City Council.

California Government Code Section 1236 states that all city, county, city and county and district employees that conduct audits or that conduct audit activities of those respective agencies shall conduct their work under the general and specified standards prescribed by the Institute of Internal Auditors' (IIA) International Professional Practices Framework (IPPF) or the Government Auditing Standards issued by the Comptroller General of the United States, as appropriate. As a government entity that must comply with this Government Code Section, the City will adopt the IIA's IPPF Standards for its internal audits.

IPPF standard 1000 states that the purpose, authority and responsibility of the Internal Audit activity must be formally defined in a written document, consistent with the Definition of Internal Auditing, the IIA's Code of Ethics and the Standards. The standard requires that the Internal Audit Manager periodically review this written document and present it to Senior Management and City Council for approval. This standard also requires that the nature of assurance and consulting services provided to the City be defined in the Internal Audit Framework.

IPPF standard 1010 states that the mandatory nature of the Definition of Internal Auditing, the IIA Code of Ethics and Standards must be recognized in the Internal Audit Framework. The standard also requires that the Internal Audit Manager discuss the Definition of Internal Auditing, Code of Ethics and Standards with Senior Management and the City Council.

IPPF Standard 1110 defines the Independence requirements for Internal Audit. It requires that the Internal Audit Manager report to a level within the City that allows the Internal Audit activity to fulfill its responsibilities. It also requires that the Internal Audit Manager confirm to City Council at least annually, the organizational independence of the Internal Audit activity. The proposed Internal Audit Framework includes a discussion of the Internal Audit group's independence and confirms to the City Council that our reporting to the City Manager through the Assistant City Manager allows for the impartial and unbiased judgement required for the proper conduct of audits.

The Internal Audit Framework requires periodic communication to the City Manager and City Council to report significant issues identified during audits and to provide periodic updates on the status and results of the annual audit plan, status of open audit recommendations and a summary of status on issues reported through the Fraud, Waste and Abuse Hotline. Staff is committed to reporting to the Audit Committee quarterly on these items.

The attached Internal Audit Framework was developed using the IIA's IPPF standards and IIA's Code of Ethics. The Framework sets out the parameters that guide the Internal Audit function and the role Internal Audit has within the City. The attached Framework includes the City's Internal Audit group's:

- Mission,
- Scope of services that can be provided,
- Commitment to quality including the professional standards and codes that will be complied with
- Authority and accountability
- Independence, and
- Responsibilities

On January 25, 2016, the Audit Committee approved this report.

**COUNCIL POLICY CONSIDERATION:**

The proposed actions are consistent with the City Council's Strategic Planning goal of maintaining fiscal responsibility.

**FISCAL IMPACT:**

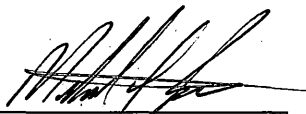
There is no fiscal impact to the budgeted appropriation as a result of this action nor will there be indirect or support cost requirements. There is no anticipated impact to other operational programs or capital projects as a result of this action.

Respectfully submitted,



RUTHE E. HOLDEN  
Internal Audit Manager  
Office of the City Manager, Internal Audit

Approved by:



MICHAEL J. BECK  
City Manager

Attachments: (1)

Attachment A – Internal Audit Framework