



Association of Local Government Auditors

**A Government Official's
Guide to Establishing a
Performance Audit Function**

The Association of Local Government Auditors (ALGA) is providing this brief introduction to performance auditing to answer questions that local government officials frequently ask about establishing an independent performance audit function. We also list resources and include a brief survey to help you assess whether a performance audit function would benefit your organization.

Frequently Asked Questions

1. **Q: What is performance auditing?**

A: In a performance audit, auditors independently evaluate the performance and management of government programs or functions compared with objective criteria or best practices. The term performance audit can encompass a variety of objectives dealing with a government's use of public resources, use of authority, compliance with laws and regulations and delivery of public services.

2. **Q: What do performance auditors audit?**

A: Performance auditors measure program performance to assess whether and how programs can be improved. They may:

- a) review program goals and objectives compared with actual results,
- b) analyze the efficiency and effectiveness of alternative methods of service delivery,
- c) determine whether programs comply with applicable laws, rules, regulations, or policies and procedures,
- d) assess whether management reports are accurate and reliable,
- e) determine whether assets are adequately safeguarded,
- f) work to detect fraud or abuse and assess controls and risks to reduce opportunities for corruption, and
- g) identify emerging issues or risks before they become crises.

3. **Q: What are the potential benefits of performance auditing in government?**

A: Performance auditing strengthens public governance by enhancing the government's accountability to the public for its use and stewardship of resources and the extent to which the public's objectives are being achieved. Performance audits often recommend improvements in service delivery, identify potential cost savings or revenue opportunities, and detect and deter improper activity. An effective, independent performance audit function can increase credibility with the public, as well as external oversight agencies, granting authorities and bond markets.

4. **Q: How can an internal office be independent?**

A: In order to be independent in fact and appearance, auditors must be free from conflicts of interest and free from interference in how they conduct and report their work. Different reporting relationships can ensure that the audit function is independent of the areas subject to audit. The auditor can be elected, appointed by a legislative body, or report to a committee, the majority of whose members are independently elected or appointed and come from outside the areas subject to audit. Regardless of the reporting relationship, the auditor's reports should be made public. ALGA's Model Legislation provides sample legislation to help ensure the independence of the audit function, including reporting relationships; how the audit director may be appointed; how the audit director may be removed from office; appointment of employees; scope of audits and other duties; access to employees, records and property; and professional auditing standards. In addition, the audit function must have systems in place to identify, resolve, or report impairments to independence and must protect their independence by not performing management functions and by not auditing their own work.

5. **Q: Who audits the auditors?**

A: Audit organizations that follow professional standards are required to have periodic peer reviews by independent reviewers. Peer reviews determine whether the audit organization's internal quality control system is suitably designed and operating effectively to provide reasonable assurance of complying with applicable professional standards.

Perceived Obstacles

Obstacles to establishing an independent performance audit function in local government usually center around one or more of the following misconceptions:

- **Too Expensive:** Skeptics often cite the cost of auditing as a disadvantage. However, it is not uncommon for an audit function to realize annual returns on investment between 200% and 400%.
- **Adversarial:** Skeptics may view the implementation of a performance audit function as pitting management against the auditors. However, an effective audit director works hard to establish a respectful working relationship with management and staff. Auditors remain independent of operations but treat other employees with professionalism and respect.
- **Lack of experience in area audited:** Managers may be concerned that audit staff lack the real world experience necessary to understand and fairly evaluate their operations. Professional auditing standards require auditors to have the requisite knowledge and skills to complete individual assignments. Auditors don't need to be subject experts in the area under review, but need to be able to provide an independent perspective and conduct work objectively using auditing standards, generally accepted management practices and common sense as guides.
- **Airing Dirty Laundry:** Government audit reports are often public records, which can increase media interest and exposure of problems. An effective audit director reports findings, conclusions and recommendations in an objective, balanced manner and includes the views of responsible officials in the report. Such public disclosure provides greater accountability and increases the public's confidence in government operations.
- **More Red Tape:** Skeptics sometimes perceive that audit recommendations will generate burdensome policies, procedures and paperwork. However, an effective performance audit function minimizes organizational "red tape" as auditors ferret out policies, procedures and management practices that contribute to unnecessary and inefficient practices.

Self-Assessment Survey

The following self-assessment survey can help you assess whether establishing a performance audit function would benefit your local government. Answer the following questions "Yes" or "No" based on your current knowledge of the organization. Be as independent and objective as possible in responding. Be aware that you may have a tendency to be overly optimistic in your response.

- ___ 1. Does a mechanism exist within the organization that serves as a monitoring and oversight function over government performance?
- ___ 2. Is the monitoring and oversight function organizationally independent of management?
- ___ 3. Does the management staff of your organization consistently provide relevant, timely and useful information regarding government performance?
- ___ 4. Are you comfortable with the reliability of analytical and performance related information provided?
- ___ 5. In your government, when inefficiencies, poor performance or substandard program results are identified, are problems addressed and resolved within a reasonable period of time?
- ___ 6. Do you feel accurately informed regarding issues affecting your government?
- ___ 7. Are you comfortable making a request for key management information regardless of political sensitivities or a desire to avoid "ruffling feathers"?
- ___ 8. Is there a sense in the community that government is accountable and responsible?
- ___ 9. If you could invest personal funds in your government operations in a manner similar to a public for-profit corporation, could you expect a reasonable return on your investment?
- ___ 10. Are you proud of your government?

A "No" response to any one item can indicate reduced accountability and trust in government operations. Consider getting in touch with ALGA for guidance on establishing an independent performance audit function if you answered "No" to one or more questions. ALGA is a not-for-profit organization.

Additional Resources Available to Assist in Establishing a Performance Audit Function

Association of Local Government Auditors (ALGA)

449 Lewis Hargett Circle, Suite 290
Lexington, KY 40503
www.governmentauditors.org

United States Government Accountability Office (GAO)

Washington, D.C. 20548-0001
(202) 512-2600
www.gao.gov

Institute of Internal Auditors (IIA)

247 Maitland Avenue
Altamonte Springs, FL 32701-4201
(407) 830-7600
www.theiia.org

Association of Government Accountants (AGA)

2200 Mount Vernon Avenue
Alexandria, VA 22301-1314
(703) 684-6931
<http://agacgfm.org>

Association of Certified Fraud Examiners (ACFE)

716 West Avenue
Austin, TX 78701
(800)245-3321
www.acfe.com



Association of Local Government Auditors

449 Lewis Hargett Circle, Suite 290
Lexington, KY 40503
p. (859) 276-0686
f. (859) 278-0507
www.governmentauditors.org

How do you keep out of harm's way?

Employ an independent performance auditor! Proactively preventing problems is what they do best.



**Association of Local
Government Auditors**

Who We Are

Improving the Quality of Local Government Auditing

Independent performance auditors:

- Possess knowledge about organizational business activities, which is critical in providing high-quality audit services.
- Provide an immediate resource to assist in crisis situations.
- Help prevent and handle fraud-related issues.

The Association of Local Government Auditors was formed in 1989 and has enjoyed a growing membership. More than 1,800 members from over 300 organizations, primarily in the United States and Canada, represent a diverse range of audit organizations in local government.

ALGA represents member organizations ranging in size from one-person shops to those with hundreds of employees.

We encourage associate memberships for auditors working in state and federal organizations, as well as private auditing firms.

**Why Your Organization
Should Have an Independent
Performance Audit Function**

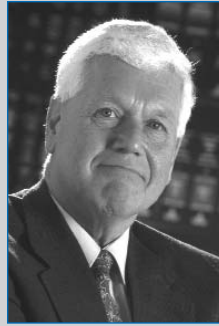
Association of Local Government Auditors
449 Lewis Hargett Circle, Suite 290, Lexington KY 40503
phone (859) 276-0686, fax (859) 278-0507
memberservices@governmentauditors.org
www.governmentauditors.org

Taxpayers Deserve Accountability

Item #5

Why Should Your Organization Establish an Independent Audit Function?

- Enhance accountability to taxpayers and bondholders.
- Build credibility with citizens.
- Help ensure that public funds are spent only in the public interest.
- Help to earn and increase taxpayer confidence and respect for government.
- Provide an independent and objective perspective so that your decisions to expend public funds involve balanced and extensive information.
- Report audited results and outcomes of programs and services.
- Identify and discourage fraud through special reviews and presence in the organization.
- Verify compliance with policies, procedures, laws and regulations.
- Identify risk.
- Proactively prevent problems by evaluating controls through regular reviews of organizational activities.
- Review and appraise reliability of financial and operating information.



“An in-house audit department is the **RIGHT** decision to make, especially in the long run.”

Audit work can lead to new revenue, cost recovery, and economic impact well beyond the audit department’s annual budget.

If structured and staffed appropriately, an independent performance audit department can be extremely effective and productive.

The Benefits of Employing Independent Performance Auditors vs. External Consultants

Independent performance auditors are:

- More economical (in-house auditors cost less per hour).
- Familiar with internal operations (no organizational learning curve).
- Quicker to respond to requests.
- Available to provide continuity of review and oversight.
- Available to follow up on recommendations and implementations.
- Committed to long-term improvements within the organization.

To find out more about how to establish your own effective performance audit function, contact us:

ALGA Member Services
 449 Lewis Hargett Circle, Suite 290, Lexington, KY 40503
 phone: (859) 276-0686, fax: (859) 278-0507
 e-mail: memberservices@governmentauditors.org
www.governmentauditors.org



Auditors can intercept *emerging concerns* before they become **COSTLY to you, your government and taxpayers.**



2010 Audit Plan

City of Sioux Falls

Presented by

Internal Audit

Rich Oksol, Lead Internal Auditor

Endorsed by

The Audit Committee of the City Council

Operational Audits

Operational audits involve an analysis of a department or division's operations. They may include appraisals of the internal control structure, conformity with laws and policies, reliability of financial reporting, and effectiveness and efficiency in meeting organizational goals. Audit reports indicate how well activities are performed, make recommendations for improvements, and offer other conclusions drawn from audit work.

Sanitary Landfill

The Sioux Falls Regional Sanitary Landfill's mission is to provide environmentally and fiscally sound solid waste management and disposal services to their customers. The Landfill fund is an enterprise fund of the City of Sioux Falls that accounts for the activities of the regional landfill. The Landfill fund's 2010 budget is in excess of \$10 million.

Workers' Compensation

The Workers' Compensation fund is an internal service fund of the City. The purpose of the fund is to provide compensation benefits to City employees for injury or illness arising out of and in the course of employment with the City of Sioux Falls as defined by state law, City ordinance, and labor contracts. The Workers' Compensation fund's 2010 budget is \$759,339.

Contracts/Agreements Audits

Contract and agreement audits are performed primarily to determine compliance with contractual terms and agreements. We may also determine if City funds are spent in a responsible manner and that, in the case of non-profit corporations, adequate governance structures are in place.

Great Plains Zoo & Delbridge Museum

The City of Sioux Falls has an agreement with the Zoological Society of Sioux Falls to manage the Great Plains Zoo & Delbridge Museum. The zoo and museum are City-owned assets.

Multi Cultural Center

The City of Sioux Falls has an agreement with the Multi Cultural Center of Sioux Falls. The agreement is for the Center to provide a) general services to the Native American, immigrant, and refugee population of the city and b) to provide a driver's education program for the immigrant and refugee population.

Construction Contracts

These audits will be of specific construction contracts to determine that all work was properly performed and documented, the City was charged the contract price for all work performed, completion dates were met, the contract was properly let, change orders were properly executed, and pay requests were properly approved. We will attempt to audit all construction contracts let in 2010 for \$1 million and over. We may audit a small number of contracts below that threshold as available audit time permits.

Sherman & Harmodon Softball Food & Beverage Concessions

The City of Sioux Falls has a contract with Crystal Ice to operate concession services at various softball fields. The City receives a percentage of revenue from the vendor.

Aquatic Centers/Community Centers Food & Beverage Concessions

The City of Sioux Falls has a contract with Papa John's to operate concession services at the City's aquatic centers and special Park/Recreation events. The City receives a percentage of revenue from the vendor.

Revenue/Cash Handling/Cash Receipts Audits

Each year Internal Audit selects City divisions or major organizational units for an audit of revenue, cash handling and cash receipts. This year we will audit **Police**. We will audit internal controls over the collection of revenue, the handling of cash, and cash receipts. These audits will determine whether departmental written procedures are being followed by staff, cash is safeguarded, proper fees are being charged, and good business practices are being observed.

Special Area Audits

Wire Transfers/ACH/Electronic Transfers of Funds

The City increasingly is using electronic transfers of funds for greater efficiencies. We will review the internal controls to determine if they are properly designed and functioning properly to mitigate risks associated with these transfers.

American Recovery and Reinvestment Act (Federal stimulus money)

The City may receive over \$8 million in federal stimulus money for various projects and programs. We will review the procedures in place to ensure proper use of funds received and proper reporting of funds received under the ARRA.

Facility License Reversion

The City of Sioux Falls receives money back from the State of South Dakota for the inspections done by City Environmental Health Specialists (inspectors). This money comes from the licenses issued by the State for facilities that serve food. This would be a review of the reversion process to determine if the City is receiving the proper amount from the State.

Capital Improvement Program (CIP)

The City of Sioux Falls prepares a five-year capital program to aid in longer-term financial planning of capital assets such as infrastructure and equipment. The capital program includes the Capital Improvement Program (CIP) and Other Capital Expenditures Program (OCEP). We will review the Capital Improvement Program to determine compliance with the CIP budget/program, adequacy of policies/procedures used in governing capital projects, efficient and proper use of resources, and may address concerns from audit scope questionnaires.

Arterial Street Program

The arterial street program is a funding partnership between the City of Sioux Falls and developers to fund new roads. The City's portion comes from the .08 cents of the second penny sales/use tax, a tax increase approved by the City Council in 2008. We will review compliance with the legislative intent of the program and procedures to ensure proper accounting of funds.

Recurring Audits/Projects

2009 Comprehensive Annual Financial Report (CAFR) Review

The CAFR contains the audited financial statements of the City of Sioux Falls. A tremendous amount of information is contained in the CAFR. However, the CAFR is over 100 pages long and readers may find this document difficult to read and understand. Internal Audit will review and analyze the 2009 CAFR and present information to the City Council on financial trends and comparisons of financial information in the CAFR with benchmark cities in the upper Midwest. For this report, we will use methodology developed by the International City/County Management Association (ICMA) publication, *Evaluating Financial Condition: A Handbook for Local Government*. The City Council will be alerted to financial trends and conditions, both favorable and unfavorable.

Citywide Disbursements

Each year Internal Audit audits a sample of disbursements in various areas such as salary & wages, general disbursements, and miscellaneous payments to determine that these disbursements were proper, authorized, supported, correctly recorded, and in compliance with laws, rules, policies, and procedures.

Technical Assistance to Committees, Council members, departments

This time is in our annual plan in order to respond to requests for information or help in specific areas not requiring an audit. The assistance does not result in a formal report, must not impair the independence of Internal Audit, nor require more than a few hours of time. Requests for assistance that will result in a formal report or require more than a few hours of time should be approved by the Audit Committee through the special project/quick response audit process.

Follow-up on Status of Audit Recommendations

We follow up with management on the status of implementation of audit recommendations made in previous years. The City Council will be provided a report each year on the status of audit recommendations.

Fraud Hotline

A fraud hotline became available to City employees in 2008 for employees to report concerns about illegal, fraudulent, or unethical activities. Employees may report their concerns anonymously. The hotline is provided by a third-party provider who uses highly-trained operators to receive and screen reports. Internal Audit investigates any allegations of fraud. Other calls are directed to the appropriate City department for investigation. Internal Audit monitors the disposition of these investigations.

Special Project/Quick Response Audits

Approximately 10% of our available hours are unassigned hours and have been set aside to perform special projects, “quick response” audits, investigations, and other work requested by elected officials or City directors and authorized by the Audit Committee.

Routine Audit Work

Asset Verifications

This activity may include unannounced verifications of petty cash funds and change funds. It may include verifications of capital equipment/noncapital inventory. Results of asset verifications will be communicated via interoffice memorandum.

Anti-fraud Procedures

Internal Audit uses Computer Assisted Auditing Techniques (CAAT) and other specific audit techniques to look for indicators of fraud in accounts payable, payroll, purchasing, and other areas. We follow up on any suspicious transactions.

Continuing Professional Development

Internal auditors are required to receive continuing professional education in order to comply with the Professional Standards of Internal Auditing. We are actively involved with the Sioux Falls chapter of The Institute of Internal Auditors (The IIA) to assist us in fulfilling this requirement. We also make use of conferences and web-based training as our training budget allows.

Notice of Hearing: NA
Date of Hearing: NA
Date Adopted: 07/24/06
Date Published: 07/28/06
Date Effective: 08/17/06

RESOLUTION NO. 104-06

A RESOLUTION ADOPTING THE INTERNAL AUDIT CHARTER FOR THE CITY.

NOW, THEREFORE, BE IT RESOLVED BY THE CITY OF SIOUX FALLS, SD:

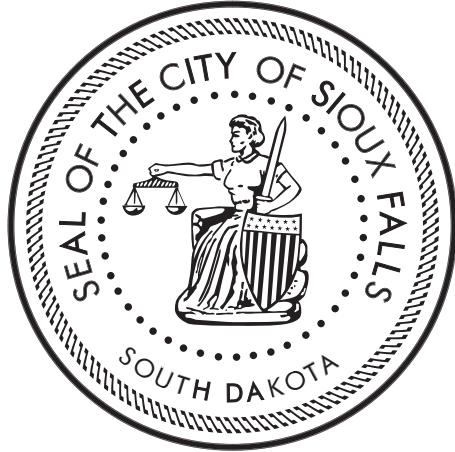
That the document attached to and part of this resolution entitled "Internal Audit Charter" is hereby approved.

That the Mayor is authorized to sign such agreement.

Date adopted: 07/24/06 .

Dave Munson
Mayor

ATTEST:
Debra A. Owen
City Clerk



INTERNAL AUDIT CHARTER

Mission

To help the City achieve the highest efficiency and effectiveness with integrity

Vision

To be a highly respected service division and a catalyst for positive change

Scope of Work

The scope of work of the internal audit activity is to determine whether the organization's network of risk management, control, and governance processes, as designed and represented by management, is adequate and functioning in a manner to ensure:

- Risks are appropriately identified and managed.
- Interaction with the various governance groups occurs as needed.
- Significant financial, managerial, and operating information is accurate, reliable, and timely.
- Employee's actions are in compliance with policies, standards, procedures, and applicable laws and regulations.
- Resources are acquired economically, used efficiently, and adequately protected.
- Programs, plans, and objectives are achieved.
- Quality and continuous improvement are fostered in the organization's control process.
- Significant legislative or regulatory issues impacting the organization are recognized and addressed properly.
- Opportunities for improving management control, accountability, and the organization's image may be identified during audits. These opportunities will be communicated to the appropriate level of management.

Accountability

The Lead Internal Auditor (LIA), in the discharge of his/her duties, shall be directed by the Audit Committee with a secondary reporting responsibility to their supervisor the City Clerk. Audit reports will be reviewed by the committee and subsequently shall be submitted to the Mayor and the City Council. The LIA shall:

- Provide annually an assessment on the adequacy and effectiveness of the City of Sioux Falls' processes for controlling its activities and managing its risks in the areas set forth under the mission and scope of work.
- Report significant issues related to the processes for controlling the activities of the City of Sioux Falls, including potential improvements to those processes, and provide information concerning such issues through resolution.
- Provide periodic updates on the status and results of the Annual Audit Plan and the sufficiency of department resources to the Audit Committee and City Clerk.
- Coordinate with and provide oversight of other control and monitoring functions (risk management, compliance, asset preservation, ethics, environmental, external audit).

Independence

To provide for independence of the internal audit activity, the Audit Committee shall annually develop an audit program for the ensuing year. The Lead Auditor will report to the Chair of the Audit Committee. All internal audit personnel auditing activities shall be directed by the Audit Committee. The City Clerk is their direct supervisor in all other matters.

Responsibility

The LIA has the responsibility to:

- Assist the Audit Committee in the development of a flexible Annual Audit Plan using appropriate risk-based methodology, including any risks or control concerns identified by management and submit all findings to the Audit Committee for their review.
- Implement the Annual Audit Plan, as approved, including, as appropriate, any special tasks or projects requested by the Audit Committee.
- Issue periodic reports to the Audit Committee. Audit Committee will review issue these reports and submit them to the Mayor and City Council.
- Establish a system to follow up on reported audit findings. The intent of this responsibility is to ensure that past audit findings are satisfactorily resolved.
- Establish a quality assurance program by which the LIA assures the quality of operations of the Internal Audit Division's activities.

- Perform consulting services, beyond internal auditing assurance services, to assist management in meeting its objectives. Examples may include facilitation, reviewing process design, training, and advisory services.
- Evaluate and assess significant merging/consolidating functions and new or changing services, processes, operations, and control processes coincident with the development, implementation, and/or expansion of City operations.
- Keep the Audit Committee and City Clerk informed of emerging trends and successful practices in internal auditing.
- Provide a report of significant measurement goals and results to the Audit Committee and City Clerk.
- Assist in the investigation of significant suspected fraudulent activities within the City of Sioux Falls and notify the Audit Committee of the results. The Audit Committee will review and report such suspected activities to the Mayor and City Council.
- Consider the scope of work of the external auditors and regulators, as appropriate, for the purpose of providing optimal audit coverage to the City of Sioux Falls at a reasonable overall cost.

Authority

The Audit Committee will authorize the LIA and internal audit personnel to:

- Have unrestricted access to all functions, records, property, and personnel of the City of Sioux Falls to the fullest extent necessary to perform the audit plan.
- Have full and unrestricted access to the Audit Committee.
- Allocate resource, set frequencies, select subjects, determine scopes of work, and apply audit techniques required to accomplish the audit objectives.
- Implement and execute all activity proposed in the Audit Program.
- Obtain the necessary assistance of personnel within City division of the City of Sioux Falls where they perform audits, as well as other specialized services from within or outside the City of Sioux Falls.

The LIA and staff of the internal auditing division are not authorized to:

- Perform any operational duties for the City of Sioux Falls or its affiliates.
- Initiate or approve accounting transactions external to the Internal Audit Division.
- Direct the activities of any City of Sioux Falls employee not employed by the Internal Audit Division, except to the extent such employees have been appropriately assigned to auditing teams or to otherwise assist the internal auditors.

Professional Standards

The internal audit activity will meet or exceed the *International Standards for the Professional Practice of Internal Auditing* of the Institute of Internal Auditors.

Amendment of the Charter

The Lead Internal Auditor is responsible for maintenance of this Internal Audit Charter to ensure that it is reviewed annually and is revised as necessary. Any amendment is subject to review and approval by the Audit Committee.

Executive Endorsement of the Internal Audit Charter

The Internal Audit Charter is the formal document that specifies the Internal Audit Division's authority and responsibilities. The charter is important to management, the activity being audited, and audit staff. Our endorsement of the Internal Audit Charter underscores the importance of the Internal Audit Division function for the City of Sioux Falls' operations. We ask for your continued cooperation as our internal auditors fulfill their important responsibility to the City of Sioux Falls.

Paul T. Reiter
Chairperson
Audit Committee

Approval Date _____

Dave Munson
Mayor
City of Sioux Falls

Approval Date _____

Bob Jamison
City Council Chair
City of Sioux Falls

Approval Date _____

Lead Internal Auditor
City of Sioux Falls

Acknowledged Date _____

Last Reviewed:
Last Revised: