

**Generally Accepted
Government Auditing
Standards (GAGAS)
External Peer Review of the
Internal Audit Activity at**



March 2012

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EXECUTIVE SUMMARY

As requested by the City of Greater Sudbury (CGS), the Institute of Internal Auditors, Inc. (IIA) conducted an independent External Peer Review (Review) of the Government Audit Office (GAO) for the Office of the Auditor General (IA Activity). The Office of the Auditor General has elected to conduct its activities in accordance with Generally Accepted Government Auditing Standards (GAGAS), issued by the Comptroller of the United States. The principal objectives of the GAGAS assessment were to 1) assess the IA activity's conformance with GAGAS, 2) evaluate the IA activity's effectiveness in carrying out its mission, and 3) identify opportunities to enhance its management and work processes, as well as its value to the City of Greater Sudbury.

OPINION AS TO CONFORMANCE TO THE GOVERNMENT AUDITING STANDARDS

Based on the results of the review, the IA activity's internal quality control system was suitably designed and operating effectively to provide reasonable assurance of compliance with GAGAS. The GAGAS delineate the basic principles and requirements of an effective governmental IA activity. The GAGAS are also intended to foster improved IA activity processes and operations.

There are three possible opinions for such review: 1) Full Compliance, 2) Satisfactory Compliance and 3) Noncompliance. **It is our overall opinion that the IA Activity is in Full Compliance with GAGAS.** (Full compliance does not imply complete or perfect conformance with GAGAS and there may be significant opportunities to improve the effectiveness of the IA activity.) The Review team identified opportunities for further improvement, details of which are provided in this report.

SCOPE AND METHODOLOGY

The review was based on the 2007 Revision of GAGAS, and covered the period from June 2009 through December 2011. The review was conducted from February 27-March 2, 2012 by a team of qualified independent audit professionals. The review was conducted in compliance with the *Peer Review Guide* published by the Association of Local Government Auditors (ALGA).

- As part of the preparation for the assessment, documents prepared by the IA activity were reviewed. The documents provided were 1) Background Information on the IA activity, 2) The Audit Organization Description of Quality Control Systems Related to Ethical Principles in Government Auditing, and 3) The Audit Organization Description of their Quality Control System. A confidential survey was conducted of the IA activity's clients (City Council Members and members of CGS Management) and the overall results were analyzed.
- During the onsite review the following were interviewed: the Mayor, seven City Councilors, eight CGS executives and the two auditors. The internal quality control system of the audit organization was reviewed and tests were conducted in order to determine if the internal quality control system operated to provide reasonable assurance of compliance with the GAGAS issued by the GAO. An exit briefing was conducted with the Mayor, the Audit

Committee Chairman and the auditors from the Office of the Auditor General to discuss the observations and recommendations.

POSITIVE ATTRIBUTES

The Office of the Auditor General was established in June 2009 and is still a relatively new IA activity. Below are additional observations that came about from the assessment activities and the review team's collective experience in internal auditing:

- Establishing a new IA activity can be a very challenging experience. All parties agreed on the importance of – and the need for – an effective IA activity.
- The Office of the Auditor General has established a solid foundation for the IA activity.

OBSERVATIONS/RECOMMENDATIONS

As is the case with many new IA activities, the IA Activity has a number of opportunities to improve the efficiency and effectiveness of the delivery of their services. The opportunities and recommendations are divided into two groups:

- First are “Matters for Considerations by the Audit Committee/City Council”. These matters go beyond compliance with GAGAS. They are included because of their impact to enhance the effectiveness of the IA Activity. They are based on the review team's analysis of IA stakeholder survey results and interview results – and the review team's awareness of successful practices used by other public sector organizations.
- Second are “Issues Specific to the Office of the Auditor General”. These matters also go beyond compliance with GAGAS. They focus on the improving the effectiveness of the IA process. They can be implemented by the IA activity with support from the Audit Committee/City Council” and CGS management.

PART I – MATTERS FOR CONSIDERATION OF CGS AUDIT COMMITTEE/CITY COUNCIL

1. Reevaluate the CGS Audit Approach. The IA Activity can deliver several types of “value-added services” to their client groups. A critical success factor in all IA activities is to clearly understand their Audit Committee's expectations for the types of value-added services they deliver. The Audit Committee should periodically A) revisit their expectations for what they expect from the IA Activity, and B) reevaluate the audit approach that can be used to meet all of the CGS IA Activity's stakeholders' needs and expectations.
2. Enhance Audit Committee Oversight. Oversight of the IA Activity can be enhanced by considering practices that have been very effective for other public sector audit committees. (Successful practice)

PART II – ISSUES SPECIFIC TO THE OFFICE OF THE AUDITOR GENERAL

1. Establish Audit Project Protocols. The efficiency and effectiveness of the IA Activity can be improved by establishing audit project protocols. The protocols would document the service commitments made by the auditors and their CGS management clients. The protocols would also cover how to resolve any disagreements or unusual situations. (Successful Practice)
2. Expand the IA Activity's Quality Control System. Currently, the IA Activity's quality control system focuses on compliance with GAGAS. The Quality Control System can be expanded to include the quality of IA services provided. The Quality Control System can also provide the Audit Committee with the performance information needed to carry out their annual review of the Office of the Auditor General. (Successful practice)
3. Streamline the Audit Reporting Process. The process of coordinating and finalizing audit reports is time-consuming, considered burdensome, and sometimes viewed as adversarial to the parties involved. The audit reporting process can be streamlined by employing some of successful practices used by other IA activities. (Successful practice)
4. Contribute to the Improvement of Risk Management/Control. Many leading IA activities are contributing to the improvement of their organization's risk management/control processes. The IA Activity's risk assessment methodology and control evaluation skills could be used to assist CGS management to proactively identify and respond to emerging risks. (Successful practice)

Additional details are provided in the main body of the report. Thank you for the opportunity to be of service to City of Greater Sudbury.



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OBSERVATIONS AND RECOMMENDATIONS

PART I – MATTERS FOR CONSIDERATION OF CGS AUDIT COMMITTEE/CITY COUNCIL

These matters for consideration originated principally from the comments received from the management survey, interviews with selected executives, and follow-up of these matters.

1. Reevaluate the CGS Audit Approach

The IA Activity can deliver several types of “value-added services” to client groups. A critical success factor in all IA activities is to clearly understand the Audit Committee’s expectations for the types of value-added services they deliver.

The Office of the Auditor General’s current mandate focuses on performance or “value for money” audits. They are also permitted to deliver non-audit services that could include advisory projects or activities aimed at contributing to the improvement of the organization’s risk management/control process.

The Office of the Auditor General is also permitted to provide supplemental services. These services could include assurance and consulting/advisory services.

- Many internal audit activities add value to the organization (and its stakeholders) when it provides objective and relevant assurance, and contributes to the effectiveness and efficiency of governance, risk management, and control processes.
- Other internal audit activities add value via consulting/advisory service activities. The nature and scope of which are agreed with the client, are intended to add value and improve an organization’s governance, risk management, and control processes without the internal auditor assuming management responsibility.

Below are some additional considerations when including other audit services:

- Currently the IA Activity is independent and reports to the Audit Committee. This should not change should the IA Activity consider providing a broader range of service to CGS management, whom in this case would be a client rather than a beneficiary of the IA Activity.
- When additional audit services are included as part of the IA Activity’s responsibilities, the internal audit charter should be updated to reflect these expectations and appropriate goals/measures should be developed to measure performance.

Next Steps for Consideration

Develop a consensus on the mix of “value for money” and assurance and consulting services that the Audit Committee wants the IA Activity to provide. If needed, update the audit plan and related documents to reflect these expectations.

2. Enhance Audit Committee Oversight

Oversight of the IA Activity can be enhanced by adopting practices that have been very effective for other public sector audit committees. While not all such practices noted are necessary, possible practices for consideration include:

- Adding one or more “independent” (i.e., not a City Council member) advisors with business management or internal auditing expertise to the Audit Committee. Alternatively, some public sector organizations have contracted with an internal audit professional to serve as an advisor to the Audit Committee.
- Providing additional internal audit education to Audit Committee members. Ideally, this training would be provided by an individual who has served as an Audit Committee member or advisor.
- Expanding the information received by the Audit Committee to include any disputed audit findings and/or management actions; and periodic reports covering the results of the IA Activity’s Quality Control Program.
- Establishing a sub-committee of the City Council to serve as the Audit Committee. Several public sector organizations have used these committees after they have added independent members and/or an internal audit advisor. In order to balance efficiency and effectiveness, many have found that an ideal Audit Committee size typically ranges from three to five members.

Next Steps for Consideration

Expand the information received by the Audit Committee on the results of the IA activity’s quality control program. Develop a consensus regarding potential need for an independent advisor and additional training.

PART II – ISSUES SPECIFIC TO THE OFFICE OF THE AUDITOR GENERAL

1. Establish Audit Project Protocols

The efficiency and effectiveness of the IA Activity can be improved by establishing audit project protocols.

- The protocols would document the service commitments made by the auditors and CGS management clients. Commitments could include timely responses to requests for information, timely communication of potential findings during the audit, reporting findings objectively, and developing management responses by set dates.

- The protocols would also cover how to resolve any disagreements (e.g., the significance of an audit finding or the adequacy of a management response) or unusual situations (e.g., access to sensitive information and coordinating certain activities).

Recommendation

Work with CGS management clients and other interested parties (e.g., the Chief of Police and the City Solicitor) to establish audit project protocols.

Office of the Auditor General Response

We agree. The Auditor General's Office is committed to continuously improving and refining its audit processes. As such, we welcome the auditors' review and recommendations. We believe their insights and perspectives will be helpful in improving the office's work.

We will work with CGS management and other interested parties to establish a formal written framework of service commitments and protocols as recommended.

2. Expand the IA Activity's Quality Control System

Currently, the IA Activity's quality control system focuses on conformance with GAGAS. The Quality Control System can be expanded to include the quality of IA services. The Quality Control System can also provide the Audit Committee with the performance information needed to carry out their annual review of the Office of the Auditor General.

Recommendation

Expand the Quality Control System to include elements such as:

- *Audit project duration,*
- *Accomplishment of key project milestones,*
- *Audit customer feedback comments,*
- *Percentage accomplishment of the annual audit plan, and*
- *Comparison to accepted capability models for public sector audit activities.*

Periodically (at least annually) report the results of the Quality Control System to the Audit Committee.

Office of the Auditor General Response

We agree. Once the Auditor General's Office has established the above framework of formal written service commitments and protocols, the recommended elements and reporting will be a logical next step in the expansion of our quality control system, and maturity of our department. The Auditor General's Office will expand our quality control system and reporting as recommended.

3. Streamline the Audit Reporting Process

The process of coordinating and finalizing audit reports is time-consuming, considered burdensome, and may be viewed as adversarial to the parties involved. Audit reports are often lengthy, very detailed, and contain background on activities audited, extensive narrative discussion, and a large number of issues and recommendations. The audit reporting process can be streamlined by employing some of successful practices used by other IA activities.

Recommendation

Consider the following suggestions to streamline the audit reporting process and improve the readability of the reports by:

- Revising the report format and contents to reduce the overall length of reports,*
- Moving background and general statistical information to the report appendix,*
- Consolidating low risk or minor issues or providing them to management outside the audit report,*
- Communicating more frequently with management to facilitate input, discuss issues and solutions, provide audit project updates, and avoid surprises,*
- Giving credit to management for solutions and other assistance offered, and*
- Using a more collaborative, less aggressive writing style.*

Consider revising the audit report format to replace the auditor “Recommendations” section with “Management Response and Proposed Actions.” This refinement would refocus management action on addressing the issue areas rather than responding to the auditor’s suggestions on how best to address the problem. If management and the auditors were not able to agree on the adequacy of management’s response, both sides could then present their viewpoints to the Audit Committee for consideration.

Office of the Auditor General Response

We agree. We have found the process of coordinating and finalizing audit reports to be time-consuming, burdensome, and sometimes adversarial to the parties involved.

We agree that the focus should be on management's response and proposed actions to address issue areas rather than on auditor's recommendations, however, we also believe that our direction from City Council has been for the Auditor General's Office to obtain adequate management responses for Audit Committee and City Council review. With City Council's direction, we will change our report format and protocol to shift accountability for satisfying themselves of the adequacy of management's responses and action plans, back to the Audit Committee and City Council.

We will discuss the auditor's suggestion with CGS management and City Council. Options may include a) Increased efforts to consolidate lower risk or minor issues in the current report style, b)

Consolidated lower risk or minor issues in a separate memo to management, or c) Consolidated lower risk or minor issues in a report appendix that only lists recommendations and proposed actions (no discussion of observations and findings).

Once again, we agree that this could further streamline our reporting process and would reduce the overall length of our reports, however, we believe that our direction from City Council has been to provide a complete account of all opportunities for improvement that we have identified, through our reports to the Council.

The Auditor General's Office is committed to continuously improving and streamlining our audit reporting process and on improving the readability of our reports. We will continue our efforts to improve the readability of our reports, and will take your suggestions into consideration as we do so.

4. Contribute to the Improvement of Risk Management/Control

Many leading IA activities are contributing to the improvement of their organization's risk management/control process. The IA activity's risk assessment methodology and control evaluation skills could be used to assist CGS management to proactively identify and respond to emerging risks.

The foundation for any successful business operation is an effective system of governance, risk management and controls. A risk management/control process can significantly enhance the accountability, integrity, and operation of the business and programmatic processes.

There are several useful risk and control models available that review factors such as the control environment, control activities, information and communication, and monitoring efforts throughout the organization. Some models also focus on the efficiency, effectiveness, and ethical climates within the entity. The International Organization of Supreme Audit Institutions (INTOSAI) model is geared to public sector organizations and would meet the City's needs to review administrative and program activities and define different levels of risks, the internal controls in place, and actions required to better address the risks.

Recommendation

Work with CGS management to establish a collaborative effort to continue to improve the City's risk management/control process. Such an effort would serve to better safeguard the City's assets, better assure compliance with laws, regulations, policies, and procedures, and provide greater assurance to the Council and the citizens about system integrity.

Office of the Auditor General Response

We agree that the effectiveness of an audit activity can often be improved through a collaborative effort, with a goal of improving the control environment, control activities, information and communication, and monitoring efforts throughout the organization.

In an initial effort, the Auditor General's Office will review features of various GRC (governance, risk management, and internal control) frameworks with management that can be referenced by managers to proactively identify and respond to emerging governance, risk and control issues.

Supplemental non-audit services often include education and advisory services aimed at contributing to the improvement of the organization's risk management/control process. While we appreciate the auditors recognition that the staff of the Auditor General's Office do have the technical skills and other competencies required to provide supplemental non-audit services, the adequacy of the Auditor General's resources must also be considered by Council at the same time, to ensure that our ability to conduct audit work is not impaired.

We will take the appropriate steps to provide these supplemental audit services based on Council's direction.