



THE CITY OF SAN DIEGO

DATE: April 27, 2011

TO: Honorable Members of the Audit Committee

FROM: Eduardo Luna, City Auditor

SUBJECT: **Office of the City Auditor Fiscal Year 2012 Proposed Budget**

Under City Charter Section 39.1, the Audit Committee recommends to the City Council the annual compensation of the City Auditor and annual budget for the Office of the City Auditor. To facilitate the Audit Committee's deliberation, I am presenting the Office of the City Auditor proposed FY 2012 budget, including staffing needs, and performance-related information for the Audit Committee's consideration. Further, I discuss a potential impairment regarding the Office budget.

Office of the City Auditor Recent Accomplishments

The Office of the City Auditor has an integral role in providing accountability and oversight of City of San Diego operations, programs, and performance. As noted in our 2010 Annual Accomplishments Report, the City Auditor's Office produced 19 audit reports, which consisted of 14 performance audits, three agreed-upon procedures reviews, and two investigated/substantiated hotline complaints. These reports contained 139 recommendations to improve economy, efficiency, and effectiveness of City government. In 2010, our Office identified nearly \$6 million in potential monetary recoveries and cost savings for the City, and since the establishment of the Office in July 2008, we have identified over \$13 million in potential monetary benefits. This equals \$2.75 in potential savings for every \$1.00 of audit costs.

The Audit Committee and City Council are committed to establishing an effective audit function and have increased the City Auditor's Office staffing from an initial five full-time equivalent (FTE) positions in July 2008 to 18.5 FTE positions in FY 2011.

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Fiscal Year 2012 Office of the City Auditor Budget Requirements

The current FY 2012 Mayor’s Proposed Budget for the City Auditor provides the same level of audit services at reduced cost of (\$102,230), as shown below.

	FY 2011 Budget	Proposed FY 2012 Budget	Change
Positions (FTE)	18.5	19.0	.5
Salaries and Wages	\$1,633,127	\$1,670,426	\$37,299
Fringe Benefits	1,010,510	836,887	(173,623)
Subtotal	2,643,637	2,507,313	(136,324)
Non-Personnel	175,169	209,263	34,094
Subtotal	2,818,806	2,716,576	(102,230)
Annual CAFR Audit Expense	942,374	793,739	(148,635)
Total	\$3,761,180	\$3,510,315	(\$250,865)

Key points of the proposed budget include the following items:

- The decision to augment City Auditor’s staffing by one position at mid-year FY 2011 instead of the beginning of FY 2011 provided personnel savings equivalent to .5 FTE for FY 2011. The proposed FY 2012 budget includes an increase in salaries of \$37,299 to annualize the remaining cost of this approved position.
- Fringe benefits costs have decreased by (\$173,623). The Financial Management Department calculated this decrease based on annual citywide rate revisions, the number of employees hired after benefit changes, benefit selections made by the employees, and other factors.
- There is an increase in budgeted non-personnel expenses totaling \$34,094 due primarily to an increase in non-discretionary IT cost allocations, such as SAP support and network access fees.
- The City Auditor’s current proposed budget, before the annual CAFR Audit expense, is \$2.7 million, which is an overall reduction of (\$102,230) or four percent from FY 2011.
- The \$793,739 annual contract cost for the Comprehensive Annual Financial Report (CAFR) audit performed by the external auditor, Macias Gini &

O'Connell LLP (MGO) is included in the City Auditor's budget. The timing and significance of expenses incurred by this contract inflates the City Auditor's annual budget and skews the true cost of performance audit services. Including the CAFR audit expense, the City Auditor's total current proposed budget is \$3.5 million. Due to the delay in issuing the FY 2010 CAFR, the City did not incur \$260,122 in CAFR audit expenses during FY11 as anticipated. This expense must be carried over to FY12, which will result in a \$260,122 increase in the City Auditor's FY12 budget. This carryover is not included in the current proposed budget. Additional audit costs are also being requested by MGO that may require an additional unspecified increase in FY 2012. We are currently discussing this request with MGO and are working with the City Attorney's Office to determine if additional costs are warranted based on the terms of the audit contract.

City Auditor's Independence Issue

We need to bring to the Audit Committee's attention a potential impairment to auditor independence regarding the Office budget process. Government Auditing Standards require that audit organizations must be free from external impairments to independence. Impairments to independence listed can include restriction on funds and external interference over the assignment, appointment, compensation, and promotion of audit personnel. The manner in which Financial Management budgets for City Auditor staff at a lower salary level than was originally approved by City Council may cause an impairment.

The Financial Management Department sets the budgeted salary for City Auditor staff based on salary levels at a certain date. The average budgeted salary for the Assistant City Auditors and Performance Auditors combined for FY 2012 is \$85,225, and the original average salary approved by the Audit Committee in FY 2008 was \$96,212. When less experienced staff have been hired at a lower salary level, the salary saving was eliminated from the City Auditor's budget. This practice may cause difficulty if the City Auditor needs to replace a less experienced auditor with an auditor with specialized skills, certifications, or experience requiring a higher salary. This puts the City Auditor in the situation where the Office may have to exceed its budget in order to hire the audit expertise needed. Financial Management has indicated that if this were to occur, they would augment our budget at mid-year. However, this action will require subsequent City Council approval. We are making the Audit Committee aware that by not budgeting staff salary at the original approved average of \$96,212, it may cause a future impairment to the City Auditor's independence due to a lack of flexibility in setting compensation levels.

Recommended Office of the City Auditor Staffing Levels

In a March 2008 study addressed to the Audit Committee, Jefferson Wells recommended that the City of San Diego should have at least 24.5 FTE audit positions to provide sufficient audit coverage for auditing high-risk areas on a three-year cycle. Currently, the office is comprised of the City Auditor, two Assistant City Auditors, 14 auditors, one fraud investigator, and one executive assistant. As a result, current staffing remains below Jefferson Wells recommended staffing level necessary to address the high-risks of City operations. In the future, the Audit Committee may want to revisit this analysis and assess the appropriate equilibrium of audit resources for an organization with \$2.7 billion budget and future audit requirements resulting from managed competition and other endeavors.

While the staffing additions in FY 2011 are paying dividends in strengthening City Auditor’s Office activities, the City remains exposed that high-risk areas will not be audited in a timely manner. The Audit Committee has previously expressed a desire to address this exposure by recommending to the City Council increased City Auditor’s Office staffing. The cost and potential savings resulting from augmenting staff is shown below.

Positions	Add Position Beginning FY 2012¹	Potential Savings Identified by FTE²	Add Position Midyear FY 2012¹	Potential Savings Identified by FTE²
Cost to Add 1.0 Auditor Position	\$167,859	\$461,612	\$83,930	\$230,808
Cost to Add 3.0 Auditor Positions	\$503,577	\$1,384,837	\$251,790	\$692,423

An investment in additional audit staff positions will likely result in future cost savings for the City. The Audit Committee may want to consider delaying additional positions until mid-year in order to minimize the increase in personnel cost. This staffing approach will require funding an audit position for half of FY 2012 at a cost of \$83,930 per FTE.

¹ One position costs includes salary of \$96,212, fringe cost of \$64,879 (as calculated by FM), and non-personnel expenses such as training and equipment totaling \$6,768.

² Potential saving is calculated based on \$2.75 in savings to \$1.00 in audit costs as identified in the City Auditor’s Annual Accomplishments reports.

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I look forward to presenting this budget at the Audit Committee meeting scheduled for May 2, 2011.

A handwritten signature in cursive script that reads "Eduardo Luna".

Eduardo Luna
City Auditor