



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Joe Rois
City Auditor

SUBJECT: SEE BELOW

DATE: April 1, 2022

**SUBJECT: RECOMMENDATION FOR DEPARTMENT-WIDE AUDITS FROM THE
CHARTER REVIEW COMMISSION**

RECOMMENDATION

Because of the need for significant ongoing audit resources, and the potential risks to the work of the City Auditor's Office, respectfully decline the Charter Review Commission's proposal for mandated department-wide audits, and do not move forward with adding it to a future charter amendment measure.

EXECUTIVE SUMMARY

On December 3, 2021, the Charter Review Commission issued its final report, recommending that the City Charter be changed to require regular department-wide performance audits. Currently, the City Auditor's annual work plan is designed to be responsive to the concerns of the City Council and the public, and address high risk areas as determined by the City Auditor's Office. The work plan is based on suggestions from City Council members, members of the public, the Administration, and staff, as well as a risk assessment of City programs and operations. The process to develop the work plan also allows for flexibility to add projects to reflect emerging issues, such as when the City Auditor proposed adding audit work related to COVID-19 expenditures during the City's emergency response to the pandemic. Without a significant increase in ongoing resources, mandating regular department-wide performance audits to the Office's work plan would severely impact the Office's ability to conduct other performance audits identified through that process.

There are both benefits and risks related to conducting large, department-wide audits. The primary potential benefit is increased audit coverage across the City. The potential risks include focusing audit resources on areas where they may not add the greatest value to the organization, and problems typically found in our current audit process may not be identified due to the large scope of the audits (i.e., increased audit risk) or because services are coordinated across departments.

No other performance audit offices in California or other large cities that we surveyed conduct department-wide audits like that described in the Charter Commission's proposal.

BACKGROUND

On December 3, 2021, the San José Charter Review Commission issued its final report¹, recommending that a new section, “ARTICLE VI SECTION 805.3 Department-wide Performance Audit” be added to the City Charter as follows:

A department-wide performance audit must be conducted to all city departments, to assess key performance against its mission, goals and objectives in order to ensure accountability and fiscal responsibility.

The constituent-facing departments shall get a department-wide performance audit at least every 6 years, while the remaining department shall get a department-wide performance audit at least every 12 years.

The auditor report shall be presented at public meetings, with trackable correction action items and follow ups.

According to the Commission’s final report, the recommendation is intended to remove political pressure from the decision-making process, as currently the City Council approves the topics for the City Auditor’s Office’s work plan.

Current Charter Provisions

Under the current City Charter Section 805, the City Auditor has the following powers and duties:

- a) Conduct or cause to be conducted annual post audits of all the fiscal transactions and accounts kept by or for the City. Such audits shall include but not be limited to the examination and analysis of fiscal procedures and the examination, checking and verification of accounts and expenditures. The audits shall be conducted in accordance with generally accepted auditing standards and accordingly shall include tests of the accounting records and other auditing procedures as may be considered necessary under the circumstances. The audits shall include the issuance of suitable reports of examination so the Council and the public will be informed as to the adequacy of the financial statements of the City.
- b) Conduct performance audits, as assigned by Council. A “performance audit” means a post audit which determines with regard to the purpose, functions and duties of the audited agency all of the following:
 - 1) Whether the audited department, office or agency, is managing or utilizing its resources, including public funds, personnel, property, equipment and space in an economical and efficient manner.
 - 2) Causes of inefficiencies or uneconomical practices, including inadequacies in management information systems, internal and administrative procedures, organizational structure, use of resources, allocation of personnel, purchasing policies and equipment.
 - 3) Whether the desired results are being achieved.

¹ <https://sanjose.legistar.com/View.ashx?M=F&ID=10354189&GUID=F27DF619-F273-4C05-9292-E375FFA42E45>

- c) Conduct special audits and investigations, as assigned by Council. “Special audits” and “investigations” mean assignments of limited scope, intended to determine:
 - 1) The accuracy of information provided to the Council.
 - 2) The costs and consequences of recommendations made to the Council.
 - 3) Other information concerning the performance of City Departments, Offices, or Agencies as requested by Council.

In addition, each month, the City Auditor is to submit to the City Council a written report of the City Auditor’s activities and findings in the immediately preceding calendar month.

Audit Work Plan

The City Auditor’s annual work plan is designed to be responsive to the concerns of the City Council and address high risk areas as determined by the City Auditor’s Office. The City Auditor develops a proposed work plan based on suggestions from City Council members, members of the public, the Administration, and staff, and a risk assessment of City programs and operations. The risk assessment is based on different factors, including the level of expenditures or revenues of department services, number of staff, date of last audit, and whether there is a pending audit request.² The scope of work, or the number of projects, is based on staff capacity.

The City Auditor submits the proposed work plan for approval to the City Council’s Rules & Open Government Committee. The work plan consists of a mix of projects, including performance audits of City programs and services, recurring projects such as the Office’s Annual Report on City Services and the Semi-Annual Audit Recommendation Status reports, and oversight for the City’s external financial audits.

Proposed performance audits cover a range of topics to provide coverage across City departments. Consistent with City Council direction in December 2020, the work plan includes performance audits of programs in at least three constituent-facing departments to identify cost savings and process efficiencies. In addition, there may be Citywide projects (e.g., Citywide management of federal grant funds) or audits of services provided by partner organizations (e.g., annual performance review of Team San Jose).³

The City Auditor can also propose new audits during the year that reflect emerging issues. This occurred during the early months of the COVID-19 pandemic, when the City Auditor proposed adding audit work related to COVID-19 expenditures.⁴ In addition, the City Council may also request to add audit projects to the work plan to address specific concerns that may arise. For example, in November 2020, the Rules Committee requested an audit of Code Enforcement management oversight after the arrest of a former code inspector for abusing his position for personal gain. This flexibility allows the Office’s work plan to be responsive to the needs of the City and add the greatest value.

² Further information about the development of the work plan can be found in [City Policy Manual 6.1.2 Audit Review and Follow-Up Procedures](#)

³ The City Auditor’s annual work plans can be found at <https://www.sanjoseca.gov/your-government/appointees/city-auditor/annual-work-plans>.

⁴ See March 2020 monthly report of activities at <https://www.sanjoseca.gov/home/showpublisheddocument/56644/637220406670370000>

ANALYSIS

Scope of Work of the Charter Review Commission's Proposal

The Charter Review Commission's recommendation is to mandate department-wide performance audits on a regular basis for both constituent-facing departments (every six years) and non-constituent facing departments (every 12 years). The City Council and the City Auditor would need to consider two aspects of the proposal in determining how to meet the intent of the proposal.

1. Defining a "constituent-facing department"

What constitutes a "constituent-facing" department is not defined in the proposal. There are departments that provide both services that are "constituent-facing," as well as internal support services to other City departments. For example, the Information Technology Department manages constituent-facing SJ 311 operations, as well as provides information and technology support to the organization overall. Public Works similarly provides both constituent-facing services such as the Animal Care Center and construction of public facilities, and support services (e.g., facilities and fleet management).

The City also provides some services through different offices within the City Manager's Office, such as the Office of Economic Development and Cultural Affairs (OEDCA) and the Office of Emergency Management (OEM). The size of the offices and the scopes of their work vary and would need to be considered. There are also Council-appointed offices (i.e., the offices of the City Attorney, City Clerk, City Manager, and Independent Police Auditor), and the Office of Retirement Services.

Including these offices, the City Auditor would need to complete at least three department-wide audits each year to meet the intent of the Charter Review Commission proposal.⁵ Excluding these offices, the City Auditor would need to complete about 2.5 department-wide audits annually.

2. Defining the scope of a department-wide audit

The City Auditor's Office generally conducts audits of programs or services within a department rather than department-wide audits. The reason for this is that program or service-level audits allow audit staff to conduct deep analyses of programs to identify specific efficiencies or areas of improvement. Audit staff do extensive testing of program-level data; create process maps, including identifying roles and responsibilities of staff at different levels; conduct interviews and "ride-alongs" with staff; review best practices and other jurisdictions' practices; and other analyses.

The City Auditor's Office has not generally conducted department-wide performance audits. The primary reason is the size of City departments and the scope of the services provided. One exception

⁵ Constituent-facing departments are assumed to be the Airport; the City Clerk's Office; the City Manager's Office; Community Energy; Economic Development and Cultural Affairs; Emergency Management; Environmental Services; Fire; Housing; Independent Police Auditor; Information Technology; Library; Parks, Recreation and Neighborhood Services; Planning, Building and Code Enforcement; Police; Public Works; and Transportation. Non-constituent facing departments are assumed to be the City Attorney's Office, Finance, Human Resources, and Retirement Services.

in recent years was a 2015 audit of the Office of the City Clerk.⁶ At the time of that audit, the Clerk's Office had 15 full-time equivalent (FTE) positions and had a budget of \$2.6 million. By comparison, larger constituent-facing departments may have hundreds of FTEs (or in the case of the Police Department, more than 1,700). Department budgets also range in the tens to the hundreds of millions of dollars. In one example, the Environmental Services Department's FY 2021-22 Adopted Operating Budget totaled \$393 million, and the department had over 770 FTE. The department also has a large capital budget, primarily related to the Regional Wastewater Facility.

Because of the size and scope of services of City departments, the level of detailed program-level testing would not be possible across all department programs or services (e.g., creating process maps or detailed analysis of performance data across all department programs). As a result, the scope of work for the audit would likely be at a high level, and focus on how funds were expended across the department, staffing trends, and whether the department met defined performance targets. To complete the required number of department-wide audits proposed by the Commission, the scope would not likely include deep reviews of individual programs to identify service level improvements.⁷

Survey of Other Jurisdictions

The City Auditor surveyed other performance audit offices in California and other large cities that provide comparable performance audit services. No other auditors that responded conducted department-wide audits like that described in the Charter Commission's proposal.⁸

Staffing Needs and Budget Impacts

In its final report, the Charter Commission noted that the proposed change may require increasing budget and staffing in the Auditor's Office. To conduct at least three department-wide audits would require two three-person audit teams under the overall supervision of a supervising auditor. In total, seven new audit staff would be required to complete the new mandated audit work without impacting the Office's ability to conduct other performance audits or recurring projects. New staff would include:

- 1 Supervising Auditor to oversee the department-wide audit function
- 2 Senior Program Performance Auditors to lead individual department-wide audits
- 4 Program Performance Auditor I/II's to staff the department-wide audit teams

Overall, the ongoing cost of staffing this additional work would be between \$1.5 million and \$1.6 million annually.⁹

⁶ [Office of the City Clerk: Streamlining Processes and Clarifying Roles Can Better Ensure Compliance with Statutory Responsibilities](#)

⁷ Currently, the Office prepares an Annual Report on City Services that provides high-level performance data for all City departments on the cost, quantity, quality, timeliness, and public opinion of services provided by each department. It also includes historical trends and comparisons to targets and other cities when available. It does not include recommendations.

⁸ California cities surveyed include Berkeley, Oakland, Sacramento, and San Diego. Non-California jurisdictions include the cities of Atlanta, Austin, Kansas City, Portland, Tempe, and Seattle, and King County, WA. The Sacramento City Auditor did note that in 2011, they were asked to conduct a department-wide audit of Sacramento's utilities department, which they contracted out because of the resources required. Similarly, Oakland noted they were asked in 2009 to conduct a department-wide audit of their public works department. It was contracted out for the same reason.

⁹ The variation is due to the difference in the cost for Program Performance Auditor I and Program Performance Auditor IIs.

Adding seven new auditors would increase overall staffing in the Office from 13 FTE (which includes the City Auditor, the Executive Assistant to the City Auditor, and 11 audit staff) to 20 FTE. Additional costs would be required to provide laptops and other resources, including annual training as required by Governmental Auditing Standards. Lastly, the City Auditor's Office workspace would need to be reconfigured, or new space would need to be identified to accommodate the larger staff. As it is currently designed, the office could not accommodate 20 staff.

Potential Benefits

Adding audit staff and conducting department-wide audits would increase audit coverage in the City, and further the Office's mission to independently assess and report on City operations and services. It would allow the Office to further strengthen public accountability over City programs.

Potential Risks

There are four primary risk areas or potential concerns with the proposed Charter amendment:

1. With mandated department-wide audits, audit resources may not be directed to the highest risk areas in the City. The current proposed work plan is developed using a risk-based approach to identify audit topics. During an audit, we identify areas of risk within a program to focus our detailed analysis. The purpose of this is to ensure audit resources are directed to the areas of greatest risk and where the Office can add the greatest value. This results in focusing audit work where we see performance deficiencies, weak internal control structures, or other identified risk areas. With mandated department-wide audits, audit resources could be directed to areas of lower risk and where we may not provide high value. It should be noted that in its final report, the Charter Review Commission noted that the change "may take resources away from areas where auditing is more important."
2. Large, department-wide audits would increase audit risk, which refers to the possibility that an auditor's findings, conclusions, recommendations, or assurance may be improper or incomplete. Factors that can affect audit risk include the size of an audit subject in terms of budget, staffing, or number of residents served; complexity of the audit subject; and the adequacy of the subject's current systems and processes. As a result, a potential deficiency at a program level may not be identified in the context of an audit that covers a full department. This would be particularly challenging if a program did not have systems in place that provided meaningful data that auditors could rely upon. Audit risk is generally addressed by expanding and extending the scope of audit testing and adding resources. As described earlier, because of the size and scope of services of departments, expanding the scope of work to include detailed program-level testing would limit the Office's ability to complete timely projects and meet the timeliness goals in the proposal.
3. Department-wide audits may limit the ability to fully audit services that are coordinated among multiple departments. For example, in 2021, the Office issued an audit related to Municipal Water billing and customer service. These functions are provided by three different departments: Environmental Services operates and maintains the water system, Finance manages customer billing and payment processing, Information Technology oversees the Customer Contact Center and handles customer inquiries. An audit of these individual departments

separately would have limited the Office's ability to address the overall service, and provide the full range of recommendations that came from the audit.

4. Insufficient funding for additional audit staff would significantly affect the Office's ability to conduct other performance audits. As noted previously, we estimate that the work would require seven auditors. Currently, there are 11 FTE for audit staff in the Office's budget. Absent additional resources, this would leave just four auditors for our normal performance audit workload. Our proposed work plan for FY 2021-22 included 12 performance audits (seven of which were in process). We would likely be able to propose just 3-4 program-level performance audits in the future if department-wide audits were added to the City Charter as proposed (absent the new resources).

CONCLUSION

The City Auditor's Office thanks the Charter Review Commission for its work. The recommendation for department-wide audits can increase audit coverage across the City, and help increase the transparency of operations Citywide. However, it would require significant new audit resources to accommodate the additional workload without impacting current operations. Department-wide audits may also focus audit resources where they may not add the greatest value, and carry high audit risk of not identifying program-level deficiencies, or improvements for programs where work is coordinated across departments.

CLIMATE SMART SAN JOSE

The Charter Review Commission proposal would not impact the City's Climate Smart San Jose goals.

PUBLIC OUTREACH

This memorandum will be posted on the City's Council Agenda website for the April 11, 2022 special meeting of the City Council.

COORDINATION

None

COMMISSION RECOMMENDATION/INPUT

This report responds to recommendations from the 2021 San José Charter Review Commission, which released its final report on December 3, 2021.

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CEQA

Not a project. PPI7-008. General Procedure & Policy Making resulting in no changes to the physical environment.

A handwritten signature in black ink, appearing to read 'Joe Rois', with a stylized flourish at the end.

Joe Rois
City Auditor

For questions, please contact Joe Rois, City Auditor, at 408-535-1239.