

**DETROIT CHARTER REVISION COMMISSION**

**PROPOSAL/ISSUE REVIEW SUMMARY**

**ISSUE NUMBER:** BF 23

**ISSUE CATEGORY:** Budget & Finance

**SOURCE:** Mark Lockridge, Deputy Auditor,  
Letter sent via Email 11/5/10

**RELATED CHARTER SECTIONS:** 4-205 ([Auditor General] Powers and Duties)

**RELEVANT ORDINANCE SECTION:**

**RELEVANT LAW(S):**

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**ISSUE/PROPOSAL STATEMENT:** Change from 2 year rotating audits to annual risk based audit plan and make annual financial analysis of non-risk based departments and operations.

**Sec. 4-205. Powers and Duties (of the Auditor General)**

The Auditor General shall:

*(Currently, paragraph 1 reads as follows)*

1. Make audits of the financial transactions of all City agencies at least once every two years or as otherwise directed by the City Council. The Auditor General shall have access to the financial and other records of all City agencies at any time.

*(Proposed revision to paragraph 1)*

1. Make audits of the financial transactions, performance, and operations of City agencies based on an annual risk-based audit plan prepared by the Auditor General, or as otherwise directed by the City Council. Audits shall focus on high risk agencies and/or processes identified in the annual risk-based audit plan. Make an annual financial analysis of all agencies not selected for audit in the current year. The Auditor General shall have access to all financial records, human resource records, and other sensitive records of all City agencies at any time.

**RATIONALE:** : “The constraint that paragraph 1 of Sec. 4-205 mandates the Auditor General to prepare the annual audit plan based on auditing all City agencies in a rotating fashion, without considering the level and the impact of risk, which varies for every agency. For example, the General Services Department (GSD), which has a \$49.3 million budget and more than 400 employees, or the Police Department (DPD), which has more than a \$400 million budget and over three thousand employees, both are inherently more risky than the Ombudsperson, which has a budget of \$1.1 million and seven employees, or the Department of Administrative Hearings with a budget of less than \$1.0 million and only three employees. Follow-up audits on departments such as GSD, DPD, and other high-risk agencies usually reveal more weaknesses, and add more value than do routine audits of significantly less risky agencies. Analytical procedures on an annual basis, and limited testing if needed should be more than sufficient to monitor low-risk agencies. Less than ten years ago, the OAG had a budget of more than 30 employees. Today, our budget is 17 employees.

"In private industry it is common to perform analytical procedures on the low-risk areas that were not subjected to audit to determine if anything out of the ordinary occurred during the year and if so, to investigate further and possibly include the low-risk area in the audit plan for the year.

"According to an article in the Internal Auditor, August, 1997 by David McName (published by the Institute of Internal Auditors):

"Risk assessment in internal auditing identifies, measures, and prioritizes risks so that focus is placed on the auditable areas of greatest significance. In individual audits, risk assessment is used to identify the most important areas within the audit scope. Risk assessment allows the auditor to design an audit program that tests the most important controls, or to test the controls at greater depth or with more thoroughness. **Risk-based auditing (RBA)** extends and improves the risk assessment model by shifting the audit vision. Instead of looking at the business process in a system of internal control, the internal auditor views the business process in an environment of risk. It's a straightforward paradigm: an audit focusing on risk adds more value to the organization than an audit focusing only on controls." –Mark Lockridge, Deputy Auditor, Letter emailed 11/5/10

Answers to follow-up questions posed to Office of Auditor General.

1. What will be the plan for auditing departments and operations considered less risky if your suggested approach was adopted?

Departments considered "low risk" would indeed be audited on a rotating basis, but not necessarily within every two years. Most likely low risk departments would be audited every three to four years. In the interim, the plan would include an annual financial analysis of all City departments considered low risk to determine if there were any unusual transactions or anomalies from year to year. The analysis would include obtaining reasonable explanations and verifications for unusual or significant changes in financial balance accounts according to the City's general ledger. Limited audit procedures would be performed to verify the validity of unusual transactions or anomalies.

The Charter states that the Auditor General shall "make audits of the financial transactions of all city agencies at least once every two years or as otherwise directed by the city council." Historically, the OAG performs several audits per year as direct requests from City Council. Those requests are often based on significant risks as viewed by City Council. Additionally, the OAG has incorporated about 20% of its audits for fiscal 2010-2011 to the American Recovery Reinvestment Act (ARRA) funds. The FED has deemed that all ARRA local audits as high risks (there are significant risks of paying the Federal Government back

for ARRA funds not properly administered). Our resources are already directed toward agencies and processes that are considered significant (or risky) by City Council. The OAG would be more effective if it to could focus first on those agencies and areas that pose the most risks and impact to the City.

2. What evidence or support do you have that the current approach results in significant audit findings with high-risk Departments and operations going unaddressed during the 2 year rotation cycle?

The evidence rests within our audits. Our audits of high risk departments yield significant findings with potentially high impact to the City. By virtue of their size and resources the findings are usually more significant. It is more often fruitful to perform

follow-up audits, which are limited in scope to the prior audit findings, on departments with significant findings. However, often times we forego the follow-up to pick the next audit in line, even if it is a low-risk department.

The Police Department, Fire Department, Department of Public Works, and Department of Transportation have the highest payout for claims and litigation year after year. The Law Department could verify this.

We issued an Audit of the General Services Department (GSD) in July 2008, the major findings of which related to the lack of physical controls over the City's fuel supply. In March 2010, we issued another audit report on GSD and the major findings were somewhat of a repeat of the audit two years earlier. This was an audit where a six-month follow-up audit may have saved the City untold dollars because of the lack of controls that existed over the City's fuel.

**ANALYSIS:**

**DISPOSITION/COMMISSION ACTION:**

**NOTES:**