



SURPRISE

ARIZONA

Annual Internal Audit Activity Report FY2018-2019

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INTRODUCTION

The Annual Internal Audit Activity Report (Report) serves to communicate the outcomes of the City of Surprise Internal Audit (IA) activity for FY2018-2019 and to demonstrate accountability to the Annual Audit Plan. The Report provides a summary of activities undertaken by the City of Surprise IA during the past fiscal year and outlines goals and challenges for FY2019-2020.

HISTORY

The City of Surprise (Surprise) IA function was established in November 2015 as an independent, objective assurance and consulting method to assess Surprise operational controls, governance, and risk management processes. Surprise IA reported functionally to the Audit Committee and administratively to the City Manager from November 2015 to November 16, 2018. As of November 17, 2018, Surprise IA reports administratively to the Assistant City Manager. The dual reporting structure is designed to strengthen the independence of Surprise IA and audit activity.

In 2015, policies and procedures were developed and documented to foster consistency in audit engagements and to serve as a training tool for future IA staff members. In June 2019, changes were made to the Surprise IA Manual effective July 1, 2019 to comply with the 2018 Generally Accepted Government Auditing Standards (GAGAS) updates. Surprise IA's authority to perform audit activity as required by GAGAS was granted by Ordinance #2016-26, adopted by the Mayor and City Council on September 6, 2016.

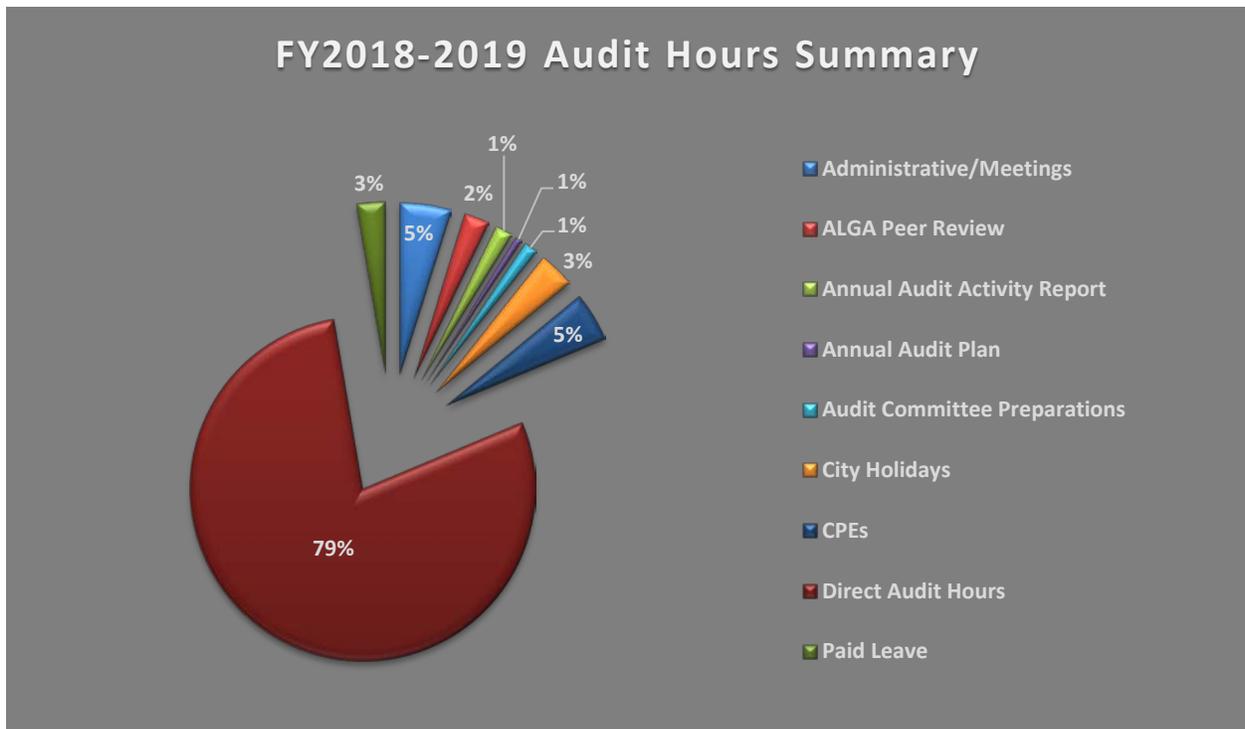
An Audit Committee was established on April 14, 2016, to assist the Surprise IA function with identifying opportunities to minimize risks, maximize efficiency and effectiveness and strengthen public accountability. Authority was granted to the Audit Committee with the adoption of Ordinance #2016-25 by the Mayor and City Council on September 6, 2016. The seven-member committee consists of two City Council Members, two Surprise department representatives, and three citizens. Public Audit Committee meetings are held quarterly, or as needed. Four Audit Committee meetings were held during FY2018-2019. Audit Committee activities are posted on the Surprise IA internet webpage for general public access along with audit reports and the annual audit plan to foster transparency in Surprise IA activity.

As stated in the Audit Committee Bylaws, each year Surprise external auditor presents the Surprise Comprehensive Annual Financial Report and Independent Auditor's Report to the Audit Committee. This provides each member with an opportunity to directly communicate with the Surprise external auditor.

PRODUCTIVITY

Direct Audit Hours

The approved FY2018-2019 Annual Audit Plan allocated 82% of Surprise IA hours as direct audit hours. Direct audit hours consist of audits, nonaudit services (continuous review of high-risk activities), and ad hoc projects. Seventy-nine percent (2,296.50 out of 2,920) of actual available Surprise IA hours for FY2018-2019 were used as direct audit hours. Twenty-one percent (623.50 out of 2,920) of actual available Surprise IA hours were allocated to indirect audit activities consisting of meetings, training, administrative activities, peer review participation, Surprise IA quality control review, and staff benefit hours (vacation, holiday, sick leave, etc.). The 3% variance in budget to actual for indirect audit hours resulted primarily from activities related to new employee onboarding, training and weekly staff meetings which were not anticipated at the beginning of the year. Allocation of available audit hours for June 2019 was estimated for this report as the fourth quarter Audit Committee meeting occurred before June 30, 2019. The following chart summarizes the Surprise IA activity by allocated hours:



The FY2018-2019 Annual Audit Plan identified five audit projects, two continuous review projects related to inherently high-risk transactions, and one annual report on the status of audit recommendations, for a total of eight projects. Surprise IA considers a project completed when the draft report has been submitted to the applicable departments for review and management responses.

Surprise IA activity for FY2018-2019 resulted in three online audit reports published for access by citizens, four completed audit reports pending approval for distribution, two quarterly status reports pending online posting, one audit report pending management responses, and one report pending review with management. See the chart on page four for details on the 11 reports generated. The reports addressed a range of internal control topics that included:

- ✚ Account Payables Vendor Masterfile maintenance
- ✚ Adequacy and effectiveness of segregation of duties
- ✚ Assessment of benefits and enrollment management and controls
- ✚ Creation and documentation of policies and procedures
- ✚ Data access, protection, reliability, and integrity practices
- ✚ General information technology (IT) controls
- ✚ IT system privileges and access rights
- ✚ Software application implementation
- ✚ Procurement policy and procedures
- ✚ Account Receivables aging and collection practices

At the request of the Audit Committee, the Annual Audit Recommendation Status report was converted from an annual to a quarterly report. An additional 42.5 direct audit hours were reallocated to compensate for the additional reporting.

During FY2018-2019, Surprise IA worked with an external IT auditor to assess the Surprise IT Department's general and change management controls in place at the time of the audit. In compliance with GAGAS, the external IT auditor's work was overseen and approved by Surprise IA.



Three audit projects were initiated during FY2018-2019 and are currently scheduled for completion during the first quarter of FY2019-2020. One project was carried forward for initiation and completion in FY2019-2020.

Summary of Recommendations by Audit Report

Audit projects selected and completed as a part of the approved FY2018-2019 audit plan were based on the FY2015-2016 citywide risk assessment, interviews with city management and key department directors, special requests, and unplanned risks identified. Audit recommendations were developed to reduce the risk to Surprise operations and assets. Auditees were engaged and encouraged to provide feedback and comments.

The following table provides a summary of audit recommendations by audit report name:

FY2018-2019 Summary Total of Audit Recommendations				
Department		Report Name	Report Date	Recommendations
Audits and Continuous Review Projects				
1	Community Development	*Building Permits	Pending	Pending
2	Community & Recreation Services	Program Revenue	October 11, 2018	16
3	Citywide	Continuous Review – Procurement Cards	November 20, 2018	11
4	Citywide	*Continuous Review – Account Payable	April 15, 2019	9
5	Executive Session	*Executive Session	November 26, 2018 February 4, 2019	15
6	Human Resources	*Benefits and Enrollment	Pending	16
7	Human Resources	*Continuous Review - Payroll	May 7, 2019	3
Total				70
Cumulative Quarterly Status of Audit Recommendations				
8	Various Departments	**Recommendation Status Report – Q1	June 28, 2018	124
9	Various Departments	**Recommendation Status Report – Q2	October 23, 2018	30
10	Various Departments	**Recommendation Status Report – Q3	February 13, 2019	11
11	Various Departments	**Recommendation Status Report – Q4	June 19, 2019	25
Total				190

*Pending management responses, review, or Audit Committee review

**Each quarter new recommendations are added and implemented recommendations are removed.

Surprise IA will monitor each open audit recommendation as staff works to resolve identified risks.

Audit Highlights

During FY2018-2019, Surprise IA addressed a diverse range of audit topics and responded to internal control concerns as they occurred. Highlights from Surprise IA activity included:

- ✚ Addressing data integrity and establishing additional guidelines for system implementation
- ✚ Identifying additional bi-weekly payroll review procedures to reduce the risk of erroneous or accidental payroll changes occurring
- ✚ Establishing a revenue control and management policy to reduce the risk of uncollectible accounts receivable, formalize the write-off process and establish consistency in the processing of revenue transactions
- ✚ Identification of duplicate vendor payments, credit memos, purchasing card policy non-compliance, and potential employee-vendor conflict of interest

Under the recommendation to automate services, one department completed the recommendation during FY2018-2019 and commented on seeing the following improvements:

- ✚ Quicker turnaround time to complete service requests
- ✚ Eliminated steps for manual tracking
- ✚ Huge savings on copy paper and duplications of steps to complete each request

Surprise IA Staffing and Qualifications

From November 2015 to December 2018, Surprise IA services were performed by one auditor. This period included the completion of eight audit reports, development of Surprise IA policies and procedures, bylaws, and the successful completion of Surprise IA's first External Quality Control Review.

On December 17, 2018, Surprise IA was fortunate to have an additional full-time auditor's position added to the staffing level. The new position functioned as a part-time position until May 20, 2019. It is anticipated that the additional staff member will allow Surprise IA the ability to complete two standard audit reports and one to two continuous review projects per quarter. The additional staff will allow Surprise IA to respond to risk as they arise and address a wider base of city departments. This was demonstrated by the completion of the Payroll Error Review memo completed on May 20, 2019.

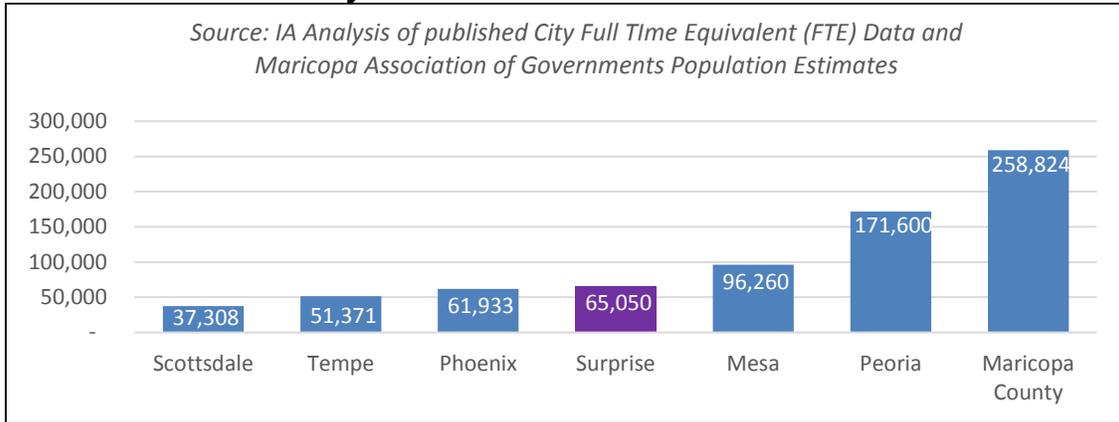
Surprise IA staff members are professionally certified in various areas of auditing and continue to seek opportunities to broaden their knowledge and expertise to better serve Surprise departments and management. Current certifications include:

- ✚ Certified Information Systems Auditor (CISA)
- ✚ Certified Internal Auditor (CIA)
- ✚ COSO Internal Control Certification

BENCHMARKING

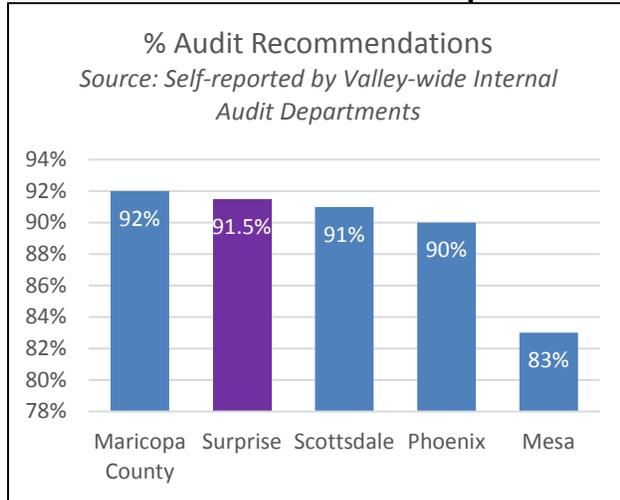
In June 2019, Surprise IA benchmarked on several metrics against other local IA functions (Maricopa County, Phoenix, Mesa, Scottsdale, Peoria, and Tempe). Not all metrics were reported or shared for all cities and some variation may exist in the specifications of how a city calculates a particular metric; as such, the numbers below should be considered estimates.

City Residents Per Internal Auditor

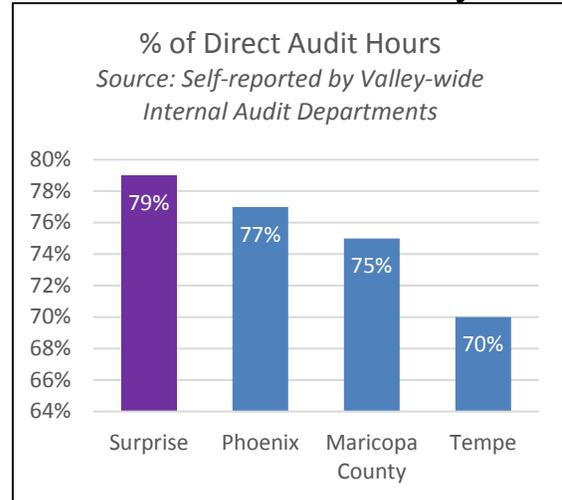


Surprise lies in the middle of the comparable range when considering the size of the city (measured by the number of city residents or city employees) and number of auditors.

% Audit Recommendations Implemented



Internal Audit Efficiency



Over the last four fiscal years, Surprise IA has made approximately 150 audit recommendations. Of those, 91.5% have already been implemented or are no longer necessary as the identified risk was mitigated in another way. Surprise IA implementation rate for audit recommendations rank in the top half of Valley IA departments. Additionally, for FY2018-2019, Surprise IA utilized 79% of their time on direct audit work which is the highest of the Valley cities tracking that information.

Other notable IA changes in the Phoenix metro-area during the FY2018-2019 include:

- Peoria, AZ (Population 168,000) established an IA function with the hiring of their first Internal Controls Manager.
- Glendale, AZ (Population 240,000) reduced the size of their IA function from two to one to utilize more external contractor support. This change was discouraged

by the national Institute of Internal Auditors (IIA) as a loss of institutional knowledge and independence in the reporting structure.

- ✚ The Phoenix branch of the IIA selected their first elected President who is a local government auditor in Scottsdale, increasing the representation of government auditors in the metro area.

PROFESSIONAL STANDARDS

Continuing Professional Education (CPE)

GAGAS 3.76 require auditors to maintain their professional competence through at least 80 hours of CPEs in every 2-year period. During FY2018-19, the two Surprise IA staff meet GAGAS professional competency requirement by participating and receiving 114 CPEs. The areas of training covered during the fiscal year included data analytics, auditing and governmental accounting standards updates, information technology security, leveraging IT to detect fraud and waste, public policy issues ahead, COSO internal control training, public finance, and various other topics. Surprise IA took advantage of free online and local membership chapter meeting participation and student rates to reduce the cost of training, when available.

To help facilitate cost-effective local training, Surprise IA staff participated in the Association of Local Government Auditor's (ALGA) Education Committee for the third year in a row. The committee provided the local region with an opportunity for 16 hours of CPE sessions and networking.

Internal Quality Control Review

GAGAS 3.93-3.95 requires IA to establish policies and procedures for quality control to provide an evaluation of whether:

- ✚ Professional standards and legal and regulatory requirements have been followed,
- ✚ Quality control system has been appropriately designed, and
- ✚ Quality control policies and procedures are operating effectively and compiled within practice

As part of the Surprise IA year-end internal quality control review, FY2018-2019 audit projects were reviewed by staff using the policy established in the Surprise IA Manual and the ALGA Engagement Review Checklist. Any identified deficiencies were corrected and discussed with staff.

External Peer Review

GAGAS 3.96 requires the IA function to obtain an external peer review at least once every three years. A successful external peer review was performed on March 22, 2018. In preparation for the next required external peer review in March 2021, Surprise IA staff has served as an ALGA peer review team member for the past two fiscal years. On August 6-10, 2018, Surprise IA staff served as a peer review team member for the State of Maryland Judiciary Internal Audit Department peer review. The participation as an ALGA peer review team member provides Surprise IA staff with an opportunity to view first hand how other governmental internal audit shops operate and comply with GAGAS.

AUDIT HORIZONS FY2019-2020

Leveraging Technology

The Surprise IA acknowledges the need to continue to grow and expand on the established auditing activities to address risks to Surprise operations and assets. IDEA CaseWare data analysis software provided an opportunity for audit activity to incorporate a more in-depth review of Surprise transactions and data. During FY2018-2019, the Surprise IA used IDEA auditing software to statistically analyze over 15,300 account payable transactions totaling over \$77 million, \$2.8 million in procurement card transactions and benefits-related payroll deductions for over 1,000 current and previous employees. The IDEA analysis identified duplicate payments, duplicate vendors, and employee vendors without the appropriate conflict of interest documentation.

Challenges

A primary challenge facing Surprise IA for FY2019-2020 is effectively leveraging technology to address a broader range of auditable Surprise units and increasing technology usage in data analytics. Several approaches will be implemented in FY019-2020 to leverage Surprise IA technology:

-  Surprise IA staff will continue to participate in IDEA training both online and through the participation with local IDEA User Groups.
-  Staff will participate in the next open Munis lab and seek assistance from expert Surprise staff members on Munis query writing.
-  Work with the IT Department to assess the feasibility of using SharePoint or other Surprise technology to develop a method for automating the process for tracking and reporting on outstanding audit recommendations.

A second challenge is the rapidly changing environment in which Surprise operates. To more effectively identify and audit risks to Surprise operations as they arise, Surprise IA is increasing the percent of the time in the audit plan dedicated to continuous review and ad hoc projects. In FY2018-2019, approximately 5% of direct audit hours were

dedicated to monitoring projects. In the FY2019-2020 proposed audit plan, approximately 6% of direct audit hours are dedicated to monitoring projects to cover risk areas including bond projects, city spending, payroll variations, key employee departures, and audit follow-up. This increase will allow Surprise IA to respond more quickly to management requests, errors identified, and changing risk landscapes.