

# **A History of Internal Audit in the City of Sioux Falls**

**Informational Meeting  
September 25, 2018**

# Current Status of Audit Division

- Internal Audit Division Employees
  - 3 FTE's Authorized
  - 1 Internal Audit Manager, 2 Staff Auditors
  - Internal Audit Manager (IAM) currently vacant
  - 1 Staff Auditor position vacant (promoted to Finance)
  - 1 Staff Auditor (Full Time) – Abby Vandelanotte
  - 1 Staff Auditor (Part Time) – Rich Oksol
  - Audit Chair /Acting Manager – Councilor Greg Neitzert

# What Do We Want from Audit?

We need to ask ourselves:

- What do we want from our Internal Audit division going forward?
- What are our priorities?
- What should the mission statement be?
- What is its reason for being?
- What can they do for us?

# What is Internal Auditing?

**Internal auditing** is “an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes”

*Definition from the IIA (International Institute of Auditors)*

# Internal vs. External Audit

- **Internal Auditors** evaluate and recommend ways to improve the effectiveness of the city's controls and processes, do performance and financial audits, and look at business practices and risk
- **External Auditors** analyze financial statements and records to ensure reporting is accurate

# Who Benefits from Internal Audit?

- Management (Administration)
- Governing Board (City Council)
- Shareholders (Taxpayers)

*The Internal Audit function provides value to all three – not just the City Council!*

# The Need for Internal Audit—City of Sioux Falls

- STI Case Study (2004)—Not a City issue, but raised important questions
- City Audit Function('02 – '04)—Not a dedicated employee until 2002
- Phillips to Falls (2004) Controversy & Pasley Park Railroad Underpass Controversy (2004)
- *City Council forced to appropriate money it did not initially approve AND after it was spent...*

# December 2004 – A Major Controversy

The City administration was forced to ask the Council for budget authority to spend the additional money from the cost overruns and change orders after it had already spent the money or entered into binding contracts with contractors who had to be paid. The City Council was notified in November 2004. However, the Mayor had entered into a contract that put Phillips to the Falls 1 million over budget in February 2004. Additional spending and contracts signed over the year without Council notice.

# Council Response—2005

- City Council contracts with State Department of Legislative Audit (DLA) to conduct special audit
  - 15 projects were sampled
  - Of those 15 projects, 11 of the projects overspent their approved budget
  - Of those 15 projects, 13 of the projects had obligations (i.e. contracts) in excess of their approved budget

# DLA Findings

- A project had overspent its approved budget in EVERY YEAR from 1995-2004
- This was NOT a one time thing
- It spanned several years and TWO administrations
- In the later years (2002-2004), the number of times projects overspent their budget increased, as did the amount of money the project exceeded its budget

# DLA Findings (2)

- Violations of City Charter and State Law
  - Spending more than appropriated by Council
  - Failing to notify Council of problem “without delay”
- Multiple instances where spending in departments exceeded yearly authorization
- One instance where Sales/Use Tax Fund (2<sup>nd</sup> Penny) over-obligated for the year

# DLA Findings (3)

- Internal Controls were lacking over budgetary accountability for CIP projects
- Reports given to the City Council were not in sufficient detail for the Council to detect problems as the situation developed
- In 2000, the Finance department was removed from the approval process for CIP project expenditures, changes, and contract approvals and was consolidated into Public Works
- Public Works was approving and overseeing its own projects

# DLA Recommendations

- City Council should receive regular reports of CIP project, departmental, and fund balances to monitor spending and have early warnings of trouble
- Council should receive a report of any carryovers to future years
- Restore Finance department in approval process of CIP project expenditures, contracts, and change orders

# DLA Recommendations (2)

- City Council should establish an audit committee
  - It “would represent the Council’s first line of defense with respect to the City’s system of internal controls”
  - Committee should have City Councilors and financial industry experts
  - Committee should be responsible for activities of an Internal Auditor
  - The hiring and firing of the Internal Auditor should be under the authority of the committee – NOT the administration – for independence

# Recommendations Implemented

- All recommendations from the 2005 State DLA Audit were eventually implemented
- An internal audit report on budget adjustments and transfers of appropriations in 2008 stated “all budget adjustments and transfers of appropriations were done accurately, timely, and in accordance with the City Charter and Executive Orders”

# Recommendations Implemented (2)

- An internal audit report in 2010 on the Capital Improvement Program (CIP) stated “We also conducted a test similar to the one performed by the state to see if there were any months in the period reviewed where a Major Organizational Unit (MOU) may have gone over budget. We **did not** find any cases of this occurring.”

# Additional Safeguards

- Full-time Council Budget Analyst
- Full-time Council Legislative Operations Manager
- City Clerk back under the Council
- Monthly Financial Reports from the Administration
- Change orders and contracts reported to the Council on the consent agenda

# Audit Committee & Audit Division Created

## Committee

- Created Nov. '05 (Ord. No. 120-05)
- First members appointed in Feb. '06
  - Five members – 2 City Councilors, 3 citizen volunteers
- Reports to the City Council
- Committee given authority to hire a Lead Auditor and additional staff if necessary
- Original members were Councilors Kevin Kavanaugh and Bob Jamison and 3 citizen members (all CPAs)

## Division

- Lead Internal Auditor hired Nov. '06
- Internal Auditor also hired
- Eventually expands to three FTEs
- Audit Charter created

# Audit Charter

- Sets forth the mission and scope of work of Internal Audit
  - Promote effectiveness and efficiency in city government
  - Identify risk
  - Ensure adequate internal controls are in place
  - Ensure accountability

# Audit Charter (2)

- **Internal Audit Manager / Lead Auditor Duties**
  - Annual risk assessment of the City
  - Develop an annual audit plan
  - Deliver reports to the Audit Committee and City Council
  - Coordinate the external audit of the City
  - Follow up on audit recommendations
  - Investigate reported issues of fraud
  - Help management become more efficient

# Audit Charter (3)

- Internal Audit Division Authority
  - Unrestricted access to City records, property, and personnel
  - Obtain assistance and cooperation from City personnel and divisions being audited
  - Implement and execute an annual audit plan
- Independence
  - Internal Audit Manager reports to Audit Committee, not the Administration

# What Do We Want from Internal Audit—Possibilities

- Proactive risk mitigation
- Performance audits
- Financial audits
- Compliance audits
- Reactive audits when problems arise
- Fraud detection and investigation
- Consulting services to city departments
- Financial analysis and budget services
  - *Next Steps...*

# Questions?



# BACK-UP SLIDES

# Benefits for the Administration

- Identify risk areas and weaknesses
- Ensure risks are being managed appropriately
- Provide consultation
- Identify processes and controls that are not working effectively
- Provide recommendations for improvement
- Help improve efficiency

# Benefits for the City Council

- Provide assurance that risks are properly managed
- Ensure internal controls are in place
- Ensure laws, ordinances, regulations, and policies are being followed
- Provide assurance that Council authorized budget is honored and finances are being handled appropriately
- Provide a check on the administration by putting a “cop on the beat”

# Benefits for Taxpayers

- Instill confidence in City government
- Protect tax dollars from waste, fraud, and abuse
- Promotes efficiency and good government
- Promotes accountability and transparency

# Case Study

## Southeast Technical Institute

- February 2004 – A former employee (teacher and administrator) is convicted of 3 counts of Grand Theft and sentenced to 17 years in prison
- Employee for 16 years at the time he was fired
- He stole \$785,000 from STI before being caught
- Method – Employee took checks from businesses intended as payment to STI and deposited them into his own bank account

# STI Case – Causes

Several issues were identified that led to the theft:

- No Internal Audit function
- Lack of Internal Controls
- Sloppy and lax procedures for handling cash, recording transactions, and a lack of segregation of duties
- Too much trust in one person – no verification

# City Auditors 2002-2004

- Audit Coordinator and 3 Auditors under Finance
- Not independent of administration
- No clear direction or significant support from administration
- Audit Coordinator had other responsibilities
- By 2004 only one Auditor remaining

# Memo to City Attorney

In March of 2004, the City Audit Coordinator sends a memo to the City Attorney referring to the STI case and stating in part:

“It is my belief that the City of Sioux Falls similarly operates with an antiquated and/or ineffective set of internal controls. I believe procedures and processes are inadequately documented, if documented at all, and a system of oversights with checks and balances operates sporadically and is only marginally effective”

# Phillips to the Falls

- Phillips to the Falls was a major road project originally programmed in the 1996-2000 CIP
- Original budget 1.16 million – final cost 10.85 million
- By December 2004 City had overspent project budget by over 3 million dollars and entered into contracts over-obligating the City by 4.3 million dollars

# Pasley Park Railroad Underpass

- 2004 CIP Project
- Original budget \$500,000 – final cost 2 million
- By December 2004 City had overspent project budget by \$457,000 and entered into contracts over-obligating the City by \$831,000

# December 2004 – A Major Controversy

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# December 2004 Council Actions

- Ordinance 119-04 provided supplemental appropriations to Parks and Public Works to cover overruns by taking money from general fund, sales tax fund, storm drainage fund, and entertainment tax reserves in the amount of 2.77 million dollars (including 1.4 million dollars from the general fund)
- Resolution 141-04 transferred 3.37 million from other departments into Parks and Public Works budgets to cover overruns
- *These actions occurred **after** the money had been spent!*