



Audit Committee Agenda

Friday, March 10, 2023

1:30 p.m.

Welcome to SANDAG. The Audit Committee meeting scheduled for Friday, March 10, 2023, will be held in person in Conference Room 7. While Audit Committee members will attend in person, members of the public will have the option of participating either in person or virtually.

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Mission Statement: *We are the regional agency that connects people, places, and innovative ideas by implementing solutions with our unique and diverse communities.*

Our Commitment to Equity: *We hold ourselves accountable to the communities we serve. We acknowledge we have much to learn and much to change; and we firmly uphold equity and inclusion for every person in the San Diego region. This includes historically underserved, systemically marginalized groups impacted by actions and inactions at all levels of our government and society.*

We have an obligation to eliminate disparities and ensure that safe, healthy, accessible, and inclusive opportunities are available to everyone. The SANDAG equity action plan will inform how we plan, prioritize, fund, and build projects and programs; frame how we work with our communities; define how we recruit and develop our employees; guide our efforts to conduct unbiased research and interpret data; and set expectations for companies and stakeholders that work with us.

We are committed to creating a San Diego region where every person who visits, works, and lives can thrive.

SANDAG
Audit Committee
 Friday, March 10, 2023

Item No.		Action
1.	Public Comments/Communications Public comments under this agenda item will be limited to five speakers. Members of the public shall have the opportunity to address the committee on any issue within the jurisdiction of SANDAG that is not on this agenda. Other comments will be heard during the items under the heading "Reports" Public speakers are limited to three minutes or less per person.	
2.	Agency Report <i>Ray Major, SANDAG</i> Deputy Chief Executive Officer Ray Major will provide an update on key programs, projects, and agency initiatives.	Discussion
3.	Update - Office of the Independent Performance Auditor Activities <i>Mary Khoshmashrab, SANDAG</i> The Independent Performance Auditor will present an update on the Office of the Independent Auditor's activities and other sharing events.	Discussion
+4.	Approval of Meeting Minutes The Audit Committee is asked to review and approve the minutes from its February 10, 2023, meeting.	Approve
Reports		
+5.	Discussion on Independent Performance Auditor Recruitment <i>Audit Committee Members Bob Monson and Stewart Halpern</i> The Audit Committee is asked to discuss on the Independent Performance Auditor Recruitment Recommendations.	Discussion/ Possible Action
6.	Member Comments Committee members may provide information and announcements under this this agenda item.	Information
7.	Upcoming Meetings The next Audit Committee meeting is scheduled for Friday, April 14, 2023, at 12:30 p.m.	
8.	Adjournment	

+ next to an agenda item indicates an attachment



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AUDIT COMMITTEE AGENDA ITEM REPORT

DATE: March 10, 2023

SUBMITTED BY: John White, Office of the Clerk of the Board

ITEM TYPE: Discussion

AGENDA SECTION: Comments and Communications

SUBJECT: Agency Report

SUGGESTED ACTION: Deputy Chief Executive Officer Ray Major will provide an update on key programs, projects, and agency initiatives.



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AUDIT COMMITTEE AGENDA ITEM REPORT

DATE: March 10, 2023

SUBMITTED BY: John White, Office of the Clerk of the Board

ITEM TYPE: Discussion

AGENDA SECTION: Comments and Communications

SUBJECT: Update - Office of the Independent Performance Auditor Activities

SUGGESTED ACTION: The Independent Performance Auditor will present an update on the Office of the Independent Auditor's activities and other sharing events.



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AUDIT COMMITTEE AGENDA ITEM REPORT

DATE: March 10, 2023

SUBMITTED BY: John White, Office of the Clerk of the Board

ITEM TYPE: Approve

AGENDA SECTION: Comments and Communications

SUBJECT: Approval of Meeting Minutes

SUGGESTED ACTION: The Audit Committee is asked to review and approve the minutes from its February 10, 2023, meeting.

ATTACHMENTS:
[AC Minutes_20230210.pdf](#)

March 10, 2023

February 10, 2023, Meeting Minutes

Chair David Zito (Board Member) called the meeting of the Audit Committee to order at 12:30 p.m.

Action: Approve

The Audit Committee is asked to review and approve the minutes from its February 10, 2023, meeting.

1. Approval of Meeting Minutes (Approve)

There were no public comments on this item.

Action: Upon a motion to approve by Vice Chair Racquel Vasquez (Board Member) and a second by Robert Monson (Public Member), the Audit Committee voted to approve the minutes from its Friday, January 13, 2023, meeting.

The motion passed.

Yes: Chair Zito, Vice Chair Vasquez, Agnes Wong Nickerson (Public Member), Stewart Halpern (Public Member), and Robert Monson.

No: None.

Abstain: None.

Absent: None.

2. Public Comments/Communications/Member Comments

Chair Zito began member comments with an Executive Committee recap and the discussion around revisions to Board Policy No.39.

Chair Zito explained that there were a few questions asked by the Executive Committee (EC) Chair to confirm and check information around the changes and return to the EC with responses.

Stewart Halpern asked if the SANDAG Office of General Counsel allows for recommendations to be sent to the Board without being vetted for compliance purposes.

Deputy General Counsel Amberlynn Deaton reiterated that the recommendation was sent to the EC as requested by the Audit Committee and that the EC requested a thorough analysis of the impacts, not for legal compliance.

Stewart Halpern clarified that a recommendation is sent to the Board, vetted for compliance purposes, and only because a Board member asked to investigate the recommendation further that staff will look into it further. He also recommended that items get vetted before getting sent to the Board to avoid spending additional time at Board level or approving items that have not been vetted for compliance.

3. Agency Report (Discussion)

Deputy Chief Executive Officer Ray Major presented an update on key programs, projects, and agency initiatives including: the Regional Plan amendment to remove the road usage charge, the 2025 Regional Plan, the removal of tracks on the Del Mar Bluffs, continued discussion on the state and federal level around the Otay Mesa East port of entry, and the Blue Line expansion and Purple Line projects. The Board of Directors also authorized the advancement of three Smart Corridor projects and adopted a vision zero resolution.

Chair Zito made a comment around the adoption of a Vision Zero policy and stated the need for aggressive goals around bike/pedestrian safety.

Action: Discussion only.

4. Update – Office of the Independent Performance Auditor Activities (Discussion)

Principal Management Internal Auditor Lloyd Carter presented an update on the Office of the Independent Auditor's activities and other sharing events, including the status of the Contracts and Procurement Audit: Part 2. Lloyd Carter also ensured the Audit Committee that everything in the Audit is fully supported.

Agnes Wong Nickerson asked a clarifying question regarding the accessibility of proper documentation.

Lloyd Carter clarified and explained that there was a delay in receiving the proper documentation.

Chair Zito asked a clarifying question on whether it has been institutional process delays rather than obstructions to the audit process.

Lloyd Carter acknowledged that he didn't think so and that their job that is being done has to be taken into consideration.

Action: Discussion only.

Reports

5. Update on Independent Performance Auditor Recruitment (Discussion/Possible Action)

The Audit Committee was asked to discuss an update on the Independent Performance Auditor (IPA) recruitment.

Chair Zito mentioned the decision from the Executive Committee meeting to have staff collect more information about similar agencies and to create a pro/con analysis of various options relative to the Audit Committee's recommendations. Chair Zito expressed the time sensitivity to the Executive Committee. Chair Zito explained that the item will return to the Executive Committee on March 17 with additional information from staff.

Stewart Halpern spoke regarding the rescinding of the recommendations that were proposed.

Bob Monson stated the timeline they had created has been rendered obsolete. He also voiced his concern for things to be done in a timely manner.

Agnes Wong Nickerson asked if there are any alternatives available that would keep the current recommendations viable.

Stewart Halpern stated that the Executive Committee asked for additional information but that it won't be until March. Stewart Halpern asked a clarifying question on whether the decision has to be presented to the full Board of Directors or if the Executive committee has authority to move this forward.

Amberlynn Deaton stated that the decision would come from the Board of Directors, after the Executive Committee.

Stewart Halpern voiced his concern on the timeline for finding a qualified replacement IPA due to SANDAG's 6- to 8-week procurement process timeline. If the decision is made to do a procurement around late March, the current IPA would be gone by the time a qualified replacement is found and there would be no overlap for training purposes.

Chair Zito stated that it is the Executive Committee's decision on the structure of the organization, whether internal or external.

Lloyd Carter mentioned that the procurement process may take as long as 6-8 months.

Robert Monson stated that the recruitment and hiring process for the current IPA was around 3-4 months, using a recruitment firm that had already been obtained by the time he joined the committee.

Chair Zito asked that staff present to the Executive Committee what their reasonable fastest timeline for the recruitment process would be, whether that be internal or external.

Ed Musgrove (Alternate Member) asked a clarifying question regarding Board Policy No. 039 and the terminal dates for Public Members.

Chair Zito responded that Stewart Halpern and Robert Monson's terms will end on May 15 and that even if changes to the Board Policy are adopted, they would not be eligible to reapply for a new term.

Ed Musgrove voiced his concern that these public members participating in the recruitment process will have their terms end during the recruitment.

Chair Zito stated that the current Board could change come February 24, and stated his desire to expedite the recruitment process.

Vice Chair Vasquez asked if it is possible to extend the current Board member terms.

Amberlynn Deaton responded that that would require an amendment to Board Policy No. 039 and has been included in the proposed amendments to the Executive Committee.

Chair Zito suggested having the discussion offline with leadership and possibly taking subsets of the Board Policy No. 39 to facilitate the current needs.

Vice Chair Vasquez suggested providing preliminary dates for the plan and that it would be valuable to keep the current board members to implement the plan they have created.

Agnes Wong Nickerson asked if there would be a way to create a parallel plan that would follow the Office of the Independent Performance Auditor (OIPA) plan while waiting for the Board to decide.

Amberlynn Deaton responded that Board Policy No. 039, section 3.1.4 states that the Board will first provide direction whether to hire an individual or a firm, and then the Audit Committee makes its recommendation on which firm or person. She also stated that the Audit Committee can continue to conduct planning work.

Stewart Halpern stated that there are some questions around the credibility of SANDAG and that it was the Board's decision to hire an internal person, even before an Audit Committee existed. He stated that there have been important findings that will better the agency and protect the taxpayer. He expressed his concern on the current Board's directions and decisions for the public.

Agnes Wong Nickerson asked if the Executive Committee is aware of the ramifications of extending the recruitment process.

Chair Zito explained the Executive Committee's point of view on how a time extension would allow for a more informed decision and reduce risk. He also voiced his concern that the process could be drawn out and last for an extended period of time. Chair Zito emphasized the importance of the internal audit team, and that he does not want the team to be put at risk.

Chair Zito proposed that the subcommittee conduct research that would help the inform the Executive Committee on their decision regarding the Audit committee's recommendations.

Chair Zito stated that it would be more expensive and less efficient to go external with the hiring process and that the organization would lose valuable information that the internal auditing team has.

Robert Monson asked for clarification on the Executive Committee's pending decision, as well as the Board's, regarding the IPA.

Chair Zito clarified that the Executive Committee is asking for clarification on the pros and cons on having an internally staffed team versus an outside firm.

Associate Management Internal Auditor Krystal Carranza explained the internal process for hiring a firm to replace the IPA, inclusive of a formal Request for Proposals, would take between 6-12 months.

Chair Zito reiterated that it would take an extended amount of time to hire a firm to fulfill the role of the IPA.

Stewart Halpern requested the presence of the Board Chair at the next meeting.

Chair Zito responded that he will extend the invite and also requested a document from the subcommittee that lays out the benefit versus issues of an external recruitment firm versus in-house staff time to replace the IPA.

Lloyd Carter asked what would happen to the OIPA's office if an external team was hired. He also asked how the OIPA office would function and what oversight would exist with an external IPA.

Chair Zito responded that he does not know the answer to these questions but points out that he emphasized these risks in the Executive Committee meeting. He also stated that he would like the office to continue to function as is.

Agnes Wong Nickerson asked if there are similar firms that have used an outside firm for internal audit functions.

Chair Zito mentions that the Executive Committee had this question and requested information on how other similar firms operate.

Stewart Halpern spoke regarding the uniqueness of SANDAG's structure and legal requirements. He recommended that staff consider this when comparing to other agencies. He also mentioned that neither SANDAG's previous internal audit function nor external auditors have found nearly as much as the current IPA's audit team has.

Chair Zito agreed that it is important that a comparison is made to other independent auditing functions and that he agrees that there is a benefit to having a team on board.

Action: Discussion only.

6. Upcoming Meetings

The next Audit Committee meeting is scheduled for Friday, March 10, 2023, at 1:30 p.m.

7. Adjournment

Chair Zito adjourned the meeting at 1:25 p.m.

Confirmed Attendance at SANDAG Audit Committee Meeting

February 10, 2023

Jurisdiction/Organization	Name	Member/ Alternate	Attended
Board Member	David Zito (Chair)	Primary	Yes
Board Member	Racquel Vasquez (Vice Chair)	Primary	Yes
Public Member	Robert Monson	Primary	Yes
Public Member	Agnes Wong Nickerson	Primary	Yes
Public Member	Stewart Halpern	Primary	Yes
Public Member	Ed Musgrove	Alternate	Yes



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AUDIT COMMITTEE AGENDA ITEM REPORT

DATE: March 10, 2023

SUBMITTED BY: John White, Office of the Clerk of the Board

ITEM TYPE: Discussion / Possible Action

AGENDA SECTION: Reports

SUBJECT: Discussion on Independent Performance Auditor Recruitment

SUGGESTED ACTION: The audit committee is asked to discuss on the Independent Performance Auditor Recruitment Recommendations.

ATTACHMENTS:

[Discussion on IPA Recruitment Recommendations.pdf](#)
[Att. 1-Association of Local Government Auditors.pdf](#)
[Att. 2-Internal_auditing-adding_value_across_the_board.pdf](#)
[Att. 3-Internal_Audit_Make_it_your_strongest link.pdf](#)

March 10, 2023

Discussion on Independent Performance Auditor Recruitment

Overview

In accordance with Assembly Bill 805 (Gonzalez, 2017) SEC. 13. Sec 132351.4. (a) (5) the Audit Committee shall recommend to the Board ... the hiring of the independent performance auditor. Board Policy 39, section 3.1.4, also states that the Audit Committee shall “Based on the Board’s direction regarding whether to hire an individual or firm, recommend to the Board which individual or firm to hire to carry out independent performance auditor responsibilities.”

Action: **Discussion/Possible Action**

The audit committee is asked to discuss on the Independent Performance Auditor Recruitment Recommendations.

Key Considerations

During the Executive Committee meeting on February 10, 2023, the Executive Committee posed questions around the pros and cons to hire an individual versus a firm to replace the Independent Performance Auditor (IPA). Today, the Subcommittee will discuss the risks of outsourcing the IPA role, the benefits of recruiting an individual versus a firm, the recommendations of the Subcommittee and other matters to support a timely recruitment process, in preparation for the IPA’s retirement on June 30, 2023.

Next Steps

Audit Committee Chair presents a recommendation to the Executive Committee and/or the Board of Directors to hire an individual to replace the IPA, based on the outcome of the discussion, the Audit Committee Chair will present any proposed recommendation to the Executive Committee and/or the Board of Directors.

Once the decision is made by the Board to recruit an individual or firm to replace the IPA, the Subcommittee will discuss next steps.

Mary Khoshmashrab, Independent Performance Auditor

Key Staff Contact: Mary Khoshmashrab, (619) 595-5323, mary.khoshmashrab@sandag.org

- Attachments:
1. Association of Local Government Auditors’ Guidance on Outsourcing and Co-Sourcing Audits
 2. The Institute of Internal Auditors’ Internal Auditing: Adding Value Across the Board
 3. Deloitte’s Internal Audit – Making it your strongest link



ALGA

Association of Local Government Auditors

Guidance on Outsourcing and Co-Sourcing Audits

ALGA Advocacy Committee

The committee works to promote the value of independent performance auditing throughout the local government community.

The committee provides professional resources and support to those in local government communities without audit functions and with new audit functions and with established audit functions.

The committee also provides support for local government communities that are considering diminishing the capacity of the audit function.

ALGA's Mission

ALGA empowers our local government auditing community through excellence in advocacy, education, communication, and collaboration to protect and enhance the public good while embracing diversity, equity, and inclusiveness.

ALGA Member Services



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Independent in-house auditors are the most effective and efficient way to deliver local government performance audit services. When local government officials are considering outsourcing audit work there are several risk factors to consider. Most importantly, the governing body should scrutinize any suggestions for outsourcing audits to ensure that the outsourcing method and subsequent management and oversight of the contract provides for and maintains the auditor's independence from management. Moreover, using contracted services to conduct audits might in some cases result in the governing body receiving less value for the money spent (compared to in-house audit services).

ALGA recommends that local governments retain independent, in-house staff capacity to conduct audits (as well as oversee co-sourced or outsourced audits) to provide the most transparent, independent and cost-effective approach to auditing for accountability. In-house auditors are better positioned to more quickly respond to requests from elected officials, monitor policy implementation and program performance, understand the organization's culture, build trust with elected officials and management, and monitor or follow up on how management implements audit recommendations. Unlike consultants, in-house auditors develop an in-depth knowledge of the entity that can be leveraged in their audit work and are available to provide continuity of review and oversight. Their commitment to long-term improvements within the organization assists elected officials in carrying out their responsibilities for good governance and prudent use of the entity's resources.

Outsourcing the audit function has critical risks

Outsourcing an entire audit function removes key benefits of an independent, in-house audit function and carries significant risks. Specifically, contracting out the entire audit function poses significant risks to the independence of the contracted auditors and credibility of their audits. In the absence of an independent auditor overseeing procurement and contract administration (such as when management or an official in the reporting chain of management directly selects and oversees the contracted auditors) the contracted auditors, the audit itself, or the audit report may be subject to management influence or interference. Additionally, some consultants hired to perform "auditing services" often issue reports that are not audits and may not assist elected officials in carrying out their duties. To safeguard the value of government audit services:

- Although not recommended, if a local government decides to outsource the audit function, they should retain at the very minimum an independent in-house chief audit executive.
- The government's chief audit executive (i.e., the head of the in-house audit function) and audit committee should retain responsibility for managing requests for proposal and awarding the contract that outsources the audit function as well as coordinating and monitoring all audits performed under contract. This will promote transparency and quality.
- The contract should require that audit work be done in accordance with recognized auditing standards, and all reports should specify which standards were followed. This promotes quality control, professional judgement, and independence.

Co-sourcing performance audits can have benefits

Co-sourcing or hiring additional resources for a specific performance audit can strengthen an independent, in-house audit function. Co-sourcing allows the in-house audit function to add to its capabilities with contracted assistance to respond more quickly to unexpected needs or to obtain specific subject-matter expertise. To safeguard the value of government audit services:

- Independent in-house auditors should be responsible for managing requests for proposal and awarding and monitoring contracts for co-sourced audits or subject-matter expertise. This will promote transparency and quality.

Mitigating risks when outsourcing annual financial audits

It is possible to outsource annual financial audits and retain a strong, independent in-house audit function. Local governments typically contract for required financial statement audits with accounting firms that specialize in financial audits. To protect the integrity of audit results and ensure clear communication with the governing body, governments should ensure:

- The contract should require that the financial statement audit work be done in accordance with [Government Auditing Standards](#) in the United States or the [Public Sector Accounting Board Standards](#) in Canada. All reports must specify these standards were followed. This promotes quality control, professional judgement, and independence.

Related/Additional Guidance

[Auditor Independence](#)

[Funding the Audit Function: Money Well Spent](#)

[Audit Committee Guidance](#)

More Info

To find additional resources from the Advocacy Committee, visit the committee page on ALGA's website at algaonline.org.

INTERNAL AUDITING:

Adding Value Across the Board

A look at the profession & corporate governance.



A CHANGING WORLD

One does not have to sit in the boardroom or occupy the CEO's chair to recognize the rapid-fire changes going on in today's business arena. News outlets regularly report on corporate scandals and frauds, privacy invasions, compromised ethics, and governance lapses. These events and the resulting laws and regulations, coupled with electronic commerce and other information technology breakthroughs; mergers, acquisitions, and other organizational restructuring; and issues related to the global marketplace all suggest that things are likely to get even more chaotic.

Thought leaders in the business community forecast still more changes and increased organizational risks:

- Increasing litigation, legislation, and regulations will carry important compliance implications.
- Information security management for critical infrastructure areas such as financial services, transportation, telecommunications, defense, utilities, and fuel will continue to require individual and collective business commitment, planning, and intervention.
- Continuing globalization will increase the complexity of principles, regulations, and the cultures in which organizations operate.
- Ever-growing competition will put even more pressure on organizations to increase productivity.
- Re-engineering, deregulation, and other change-related activities will break down traditional hierarchical structures and alter organizational reporting relationships and management responsibilities.

Each of these phenomena suggests new demands, challenges, and opportunities for management and the board. And each one also points to the necessity for competent internal auditing. Today, more than ever, internal auditing is critical to strong corporate governance, risk management, effective internal control, and efficient operations.

WHAT IS INTERNAL AUDITING?

Internal auditing is an independent, objective, assurance and consulting activity that adds value to and improves 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.

The internal audit activity provides assurance to management and the audit committee that risks to the organization are understood and managed appropriately. And it serves as an in-house consultant on many areas of interest.

Every organization, regardless of its size, should have some type of internal control system or process in place. The Institute of Internal Auditors (IIA) believes that an organization is best served by a fully resourced and professionally competent internal audit staff that provides value-added services critical to efficient and effective organizational management.

Internal audit practitioners are charged with assisting the organization in the effective discharge of responsibilities, promoting the establishment of cost-effective controls, assessing risks, and recommending measures to mitigate those risks. An integral part of the management team, internal auditors furnish top management with analyses, appraisals, counsel, and information on the activities they review. They also monitor organizational ethics.

Evaluating emerging technologies; analyzing opportunities; assessing quality, economy, and efficiency; and providing accurate and timely communication are just some of the activities internal auditors conduct on a daily basis. The comprehensive scope of their responsibilities provides them with a broad perspective on the organization. And that, in turn, makes them a valuable resource to executive management and the board of directors in accomplishing overall goals and objectives, as well as strengthening internal control and governance. This might be a lot to ask from one organizational resource, but for internal auditors – it's all in a day's work.



IN PARTNERSHIP WITH MANAGEMENT

When internal auditing is accepted and acknowledged by an organization's leaders as a management activity, internal auditors can fulfill their most fundamental role — supporting management and the board in achieving organizational objectives. And competent internal audit professionals bring to the table objectivity, integrity, expertise in communication, the ability to identify enterprisewide risks, and the skill to assess the effectiveness of controls put in place by management to mitigate those risks.

As partners to management, internal auditors are positioned to help protect the organization against both traditional and emerging risks; provide consultation about how opportunities and vulnerabilities can be balanced; and make valuable recommendations for assessing and strengthening corporate governance. The internal auditors' broad understanding of the organization and its culture prepares them for effectively monitoring risks associated with new business lines; mergers, acquisitions, joint ventures, and other partnerships; new systems deployments; restructuring; management estimates, budgets, and forecasts; environmental issues; and regulatory compliance. In order for the internal audit activity to achieve all of this and add the most value to an organization, best-practice reporting relationships should be followed. (See page 5.)

BellSouth Corporation Chairman and Chief Executive Officer Duane Ackerman clearly recognizes the value internal auditing brings to management: "Because we are in a dynamic environment — we've got new people, new technology, a new marketplace, new competitors, and a new regulation — we need to be very vigilant about the fundamentals of this business. And that's a role corporate auditing plays...the ability to collect information and impart that knowledge on processes as well as control issues and to do it constantly through all of this change. It's easy to see how incredibly important that is to the fundamental stability of this business."

Of increasing concern to management today are the risks associated with information technology and the control and auditability specifications of new systems. Internal auditors' independent review of information systems and other high-tech projects can help ensure a controlled and reliable IT environment. And their consulting services add value to the decision-making process when management must consider the cost and benefit trade-off of IT control implementation.



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PRODUCTS AND REPORTS

- 20 Questions Directors Should Ask About Internal Audit
- Audit Committee Handbook, 4th Edition

www.theiia.org

VITAL TO GOVERNANCE

Internal auditors' diverse capabilities bring tremendous value to the board and the audit committee in their corporate governance responsibilities and risk management oversight. It is critical that the chief audit executive (CAE), senior management, and the audit committee have sufficient contact and communication to ensure that the parties understand and accept their individual and collective responsibilities for risk management.

Today's audit committees must deal with complex and diverse issues and ever-increasing responsibilities. As a result of laws and regulations, such as the U.S. **Sarbanes-Oxley Act of 2002**, audit committees are being asked to monitor such areas as: management's assessment of internal controls over financial reporting; ethical complaint hotlines; enterprisewide risk management; and governance reviews, to name a few. It is critical, therefore, that internal auditors apply risk-based audit approaches to the organization's internal control system and provide comprehensive reports to the audit committee.

The risk-based approach toward auditing is mandated by The IIA's *International Standards for the Professional Practice of Internal Auditing (Standards)* and is the only way to ensure that the priorities of the internal audit activity are consistent with the organization's goals. Such an approach provides internal auditors with the opportunity to become intimately knowledgeable of the organization's risk appetite and tolerance — allowing them to target high-impact areas, appropriately allocate scarce resources, and be well positioned to advise management on vulnerabilities and corrective actions.

Implementing a risk-based approach can uncover potential organizational risks that may otherwise go undetected and provide management with a critical tool for gauging and assessing enterprisewide risk. This allows management to allocate the greatest amount of resources to the areas that will yield the highest return on investment and ensures that the organization has dedicated audit coverage for high-risk areas.

AS PART OF ITS OVERSIGHT RESPONSIBILITIES, THE AUDIT COMMITTEE SHOULD:

- Review and concur the chief audit executive (CAE) appointment, replacement, reassignment, and dismissal.
- Review/approve the internal audit charter and ensure its compatibility with that of the audit committee.
- Review the audit plan and any significant changes.
- Ensure internal auditor neutrality and objectivity.
- Review the internal audit department's budget and staffing.
- Encourage internal auditor certification and other professional development.
- Meet privately with the CAE.
- Receive reports from the CAE on audit findings and information on technological advances and trends.
- Review internal auditing's compliance with The IIA's *Standards*.



WHAT WORKS BEST

An active and knowledgeable audit committee is fundamental to achieving and maintaining an effective control environment. And an atmosphere of mutual trust and respect between the internal audit activity and the audit committee is critical to the committee's independent oversight role.

World-class internal audit departments at J. C. Penney Company, ASEA Brown Boveri, Ford Motor Company, and BellSouth Corporation offer these tips for building a strong relationship between internal auditing and the audit committee for enhanced corporate governance:

- To avoid any significant surprises, there should be straightforward, open, honest, accurate, and timely communication between internal auditing and the audit committee.
- Internal auditing should keep the audit committee members up to date on new laws, trends, and other important information and resources so they can effectively discharge their duties.
- Internal auditing should provide the audit committee with a plan to address key governance issues.
- A corporate governance program should provide a mechanism for business process improvement, integrity standards, training, a "hotline" and other reporting processes, and appropriate compliance review.
- Presentations should drive toward discussion of control issues rather than audit findings, and additional material should accompany presentations to provide contextual insight about the control issues under discussion.
- In addition to regular audit committee meetings, the CAE should have periodic meetings with the audit committee chairman and recurring closed sessions with the committee itself to discuss broader issues facing the organization.
- Internal auditing should focus on delivering results and implementing preventive actions, rather than simply uncovering problems after the fact.
- As suggested by the Internal Audit Foundation, internal auditing should perform periodic surveys to determine the specific needs of the audit committee.

KEY IIA MESSAGES ON BEST-PRACTICE REPORTING RELATIONSHIPS

- To ensure transparency and thwart collusion and conflicts of interests, best practice indicates that the internal audit activity should have a dual reporting relationship. The CAE should report to executive management for establishing direction, support, and administrative interface; and to the organization's most senior oversight group — typically the audit committee — for validation, reinforcement, and accountability.
- The audit committee of the board of directors and the internal auditors are interdependent and should be mutually accessible, with the internal auditors providing objective opinions, information, support, and education to the audit committee; and the audit committee providing validation and oversight to the internal auditors.
- The internal auditors keep the audit committee informed and up to date on the state of the organization in regard to risk, control, governance, and the coordination and effectiveness of monitoring activities.



INTERNAL AUDITING: ADDING VALUE ACROSS THE BOARD

Competitive pressures demand that today's organizations squeeze the most they can from all their resources — and as this brochure indicates, the internal audit process is clearly among the most critical. In addition to their responsibility for assessing and recommending internal controls, internal auditors' skills in risk management and their broad-based perspective of the organization uniquely position them as a valuable resource for strong corporate governance.

As a result, informed senior managers and boards are relying on internal auditors for advice and counsel on everything from analysis of operations and assessment of risk to recommendations for improved corporate governance. Moreover, internal audit practitioners are increasingly being challenged to apply their expertise in much broader ways than ever before — such as evaluating emerging technologies, detecting and deterring fraud, analyzing the effectiveness of policies and procedures, and identifying opportunities to save the organization and its shareholders money.

When it comes to adding value across the board, there's no better resource than internal auditing.



WORLD-CLASS INTERNAL AUDIT SHOPS SPEAK OUT ON THE IMPORTANCE OF THEIR RELATIONSHIP WITH THE AUDIT COMMITTEE:

"Internal auditing is the primary resource of the audit committee in carrying out its duties and responsibilities. With those responsibilities increasing and continued pressure from the SEC for financial reporting integrity, a functioning partnership of the audit committee and internal auditing is vital."

– BellSouth Corporation

"Internal auditors should not have to report through layers upon layers of management as this could compromise or dilute recommendations and their effectiveness. Audit services' relationship with the audit committee is critical and contributes to the success of our company."

– Carolina Power & Light Company

"Internal auditing's relationship to the audit committee is important to assure there are no organizational levels below the board of directors that could prevent necessary actions or appropriate decisions from taking place or being made to enhance business opportunities and mitigate risks."

– ASEA Brown Boveri

"An active and informed audit committee provides the ultimate independent and objective oversight of the corporate control environment, including focus on emerging trends and risks. Internal auditing is the primary agent of the audit committee within the company."

– Ford Motor Company

"The relationship affords auditing with some degree of independence from the organization and management. In certain cases, it can be used to ensure management addresses key findings. It is our main vehicle to communicate important issues to the entire board."

– J. C. Penney Company

The Institute of Internal Auditors (IIA) is the internal audit profession's global voice, recognized authority, acknowledged leader, chief advocate, and principal educator worldwide. Established in 1941, The IIA serves members from all around the world in internal auditing, governance, internal control, IT auditing, education, and security.

The world's leader in certification, education, research, and technological guidance for the profession, The Institute sets the *International Standards for the Professional Practice of Internal Auditing* and provides various levels of accompanying guidance; certifies professionals through the globally recognized Certified Internal Auditor® (CIA®) and specialty certifications in government, control self-assessment, and financial services; presents leading-edge conferences, seminars for professional development, and web-based training; produces forward-looking educational products; offers quality assurance reviews, benchmarking, and consulting services; and creates growth and networking opportunities for specialty groups.

The Internal Audit Foundation works in partnership with experts from around the globe conducting valuable research projects on the top issues affecting the business world today. It also delivers leading-edge educational products through the IIA Bookstore. The Institute's website, www.theiia.org, is rich with professional guidance and information on IIA programs, products, and services, as well as resources for IT audit professionals.

The IIA also brings great value to its members through *Internal Auditor*, an award-winning professional magazine, and through other outstanding periodicals that address the profession's most pressing issues and challenges and present viable solutions and exemplary practices.

And in support of quality, professionalism, and ethical practices, The Institute provides internal audit practitioners, executive management, boards of directors, and audit committees with guidance for internal auditing and governance best practices.

The IIA is dedicated to providing extensive support and services to its members, so they can continue to add value across the board.

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Internal Audit

Make it your strongest link



Forming strong linkages

An effective internal audit activity is a valuable resource for management, the board or its equivalent and the audit committee **due to its understanding of the organization and its culture, operations, and risk profile**. The objectivity, skills, and knowledge of competent internal auditors can significantly add value to an organizations internal control, risk management, and governance processes. Similarly an effective internal audit activity provides critical assurance to other stakeholders, such as regulators, employees, providers of finance and shareholders.

Essentially, Internal Audit is a control and functions by reviewing and assessing the adequacy and effectiveness of all other controls. Ideally, internal audit serves as the eyes and ears of the board and audit committee, being an essential component in the system of checks and balances.

This function must provide assurance regarding governance and controls to management and the audit committee. Also, it should contribute to improved management and control as well as to organisational performance. Internal Audit is neither an internal checker of financial transactions nor an extension of the external audit function. It is different in that it focuses on all business risks.

Internal Audit:

- **Identifies controls and control deficiencies;**
- **Identifies regulatory requirements and compliance therewith;**
- **Provides recommendations on internal control and governance improvements;**
- **Determines adherence with company policy and procedures; and**
- **Assists with channelling effective solutions for controls improvement.**

When performed by professionals with an in-depth understanding of the business culture, systems, and processes, the internal audit activity provides assurance that internal controls in place are adequate to mitigate risks, and to ensure that organizational goals and objectives are met.

Internal Audit Related Services



“Internal audit is an independent, objective assurance and consulting activity designed to add value and improve an organisation’s operations. It helps organisations accomplish their objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.”

Institute of Internal Auditors

Benefits of having a strong Internal Audit function

A successful Internal Audit function becomes a necessity when an organisation is faced with the following challenges and requirements:

- **Focus on risk management, designing internal controls to manage risk:** Internal auditors can leverage their skills by directing their efforts in the risk areas, thereby enhancing the overall efficiency of the process and adding greater value with the same set of resources;
- **Intensive use of information technology:** Information technology (IT) is invariably embedded in all spheres of activities of a modern business enterprise, from data processing to resource planning to online sales and e-commerce. Use of IT has, however, increased the threat of data theft, losses on account of systems failure, hacking/ espionage, etc. The use of IT also results in a need to comply with the cyber laws, etc.;
- **Audit Committee support and interaction:** Aligning audit committee objectives with those of internal audit helps to unify oversight and allocate limited resources in the most efficient and effective way. The internal audit function provides audit committees with relevant reports and ongoing updates. This function identifies new risks and is entrusted to conduct high-level reviews in a strategic manner. Audit committees have a great deal to gain by developing and empowering internal audit, and by working more closely with internal auditors to improve organisational oversight;
- **King III Requirement:** “A strategically positioned, competent and independent internal audit function is required to provide a written assessment of the company’s system of internal control, after having conducted a risk based internal audit. This function must have direct relationships with the audit, corporate governance and risk committees and must be strategically positioned.” (King III report);
- **Increased size and complexity of businesses:** Increased size and business spread dilutes direct management oversight on various functions, necessitating the need for a full time, independent and dedicated team to review and appraise operations;
- **Enhanced compliance requirements:** An increase in the geographical spread of businesses has led to crossing of political frontiers by businesses in a bid to tap global capital. This has highlighted the need for compliance with the laws of the home country as well as the laws of other jurisdictions as a critical factor for the ability of businesses abroad to prosper;

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

- **Unconventional business models:**
Businesses today use unconventional models and practices, for example, outsourcing of non-core areas, such as accounting. These businesses require the assurance that controls relating to these models and practices are adequate and operating effectively;
- **Stringent norms mandated by regulators to protect investors:** Regulators, in their pursuit to protect the interests of the investors, are applying ever mounting pressure and stringent norms. Compliance with the latest regulations – being ethical conduct of business, enhanced corporate governance and financial reporting requirements – should be independently assessed by a competent internal audit function; and
- **An increasingly competitive environment:**
Deregulation and globalisation have lowered the political and other barriers for entry in the markets for goods and services. The free flow of capital, technology and know-how between countries, as well as strong infrastructure has helped in decreasing the costs of production and resulted in better access to the existing and potential consumers. This in turn, has lured more and more players in the existing markets, thereby, resulting in stiffer competition. A well equipped internal audit function can assist businesses to identify opportunities for improved efficiency and effectiveness.

“As a cornerstone of strong governance, internal auditing bridges the gap between management and the board assesses the ethical climate and the effectiveness and efficiency of operations, and serves as an organization’s safety net for compliance with rules, regulations and overall best business practices.”

Institute of Internal Auditors



Making the right link

The table below illustrates both benefits and challenges organisations need to consider when deciding on where the internal audit function should be housed.

	In-source	Co-source	Out-source
	Company maintains full responsibility for recruiting, hiring, retention, development, deployment and management of internal audit team.	Company hires a limited core internal team of management and/or staff and uses an outside professional provider to supplement the team and/or to provide strategic direction to the internal audit service.	Company uses an external professional provider for all internal audit activities.
Benefits	<ul style="list-style-type: none"> Enables strong development of in-house experience; Internal resources can be a consistent, internal source of in-depth knowledge of company; Internal audit resources become networked within the organisation and integrated into company initiatives; Can enable efficient team if audit universe is homogenous; and Can be a lower cost option, depending on the efficiency and experience of internal personnel. 	<ul style="list-style-type: none"> Enables a balance of internal knowledge with external leading edge experience; Enables team resource flexibility as required (level, skill set, fit with company); Leverages subject matter specialisation when required; Enables team load levelling and flexible staffing to balance out demand without full-time commitment of resources; External providers usually maintain integrated technologies and toolsets that can be shared internally; Provides access to professional knowledge bases and benchmarks; Can be viewed as “one team” that is committed to internal goals; Can enable management development and rotation of internal resources with the external provider providing continuity; and May provide an optimal pricing structure with limited commitment. 	<ul style="list-style-type: none"> Leverages external resources for the management and execution of the internal audit function; Does not require commitment to internal recruiting, retention and development of resources; The external provider can provide a complete, turnkey approach to internal audit (e.g. methodology, tools); The entity pays for core audit time only with limited administration or overhead costs; Enables team resource variability as required (level, skill set, experience, fit with company, location); Can be a lower-cost option, but need to weigh cost and benefits, given challenges; Enables global resourcing when required for language, location, cultural understanding; and, Reduces the travel expense where the service provider has local representation amongst auditees.
Challenges	<ul style="list-style-type: none"> Permanent staffing requires significant commitment to hiring, retention and development of team members; It can be difficult to recruit and retain skilled resources; Significant internal effort is necessary to maintain a quality internal audit function; Difficult to manage the need for diverse subject matter specialisation that is required for audit needs; Difficult to build a global team in diverse locations; Can result in high travel costs; and Resources often look for employment options throughout other areas of the company. This can have advantages for company, but is also a challenge for continuity in internal audit. 	<ul style="list-style-type: none"> Requires coordination, oversight of, and contracting with external service provider; Requires hiring, training, and development of core management and/or staff;; Requires clearly defined roles/ responsibilities between internal and external resources; and May result in increased internal audit costs vis-a-vis the in-house option. 	<ul style="list-style-type: none"> Requires coordination, oversight of, and contracting with external service provider; Does not maintain value of function internally to the company; It can be a challenge to fully integrate the internal audit function into the company or as a consistent resource option for special projects; Requires independent learning curve on the organisation by an external provider; Possible loss of immediate availability of internal audit resources for sudden ad hoc requirements; Loss of training ground for management trainees, future line appointments; and May result in increased internal audit costs vis-a-vis the in-house or co-sourced options.

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