



Hamilton



City of Hamilton

External Review of the Internal Audit Division

(Contract No.: C1-01-05)

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**The City of Hamilton
External Review of the Internal Audit Division
Executive Summary**

EXECUTIVE SUMMARY

The City of Hamilton (the ‘City’) has had an Internal Audit function for many years through its predecessor municipalities. As did all City departments, the Internal Audit department went through transition with the amalgamation that occurred January 2001. The demands of the function increased given the significant breadth and complexity of the new city. Additionally the role of internal audit for all organizations has been changing: the demands to work more efficiently, to ‘add-value’ and to strengthen governance, have led to a significant shift in management expectations of internal audit and in internal audit’s role within the organization. Specifically for the City, concerns had been expressed by the external auditors regarding the strength of the oversight of the internal control environment and the resources of Internal Audit to provide the assistance needed to strength the governance level. As a result, the City engaged Booker & Associates to undertake an organizational review of the internal audit function within the City and to identify what role the function should be providing and what improvements should be made to how the function operates.

Booker & Associates reviewed the current practices of the City’s internal audit function, and conducted interviews with staff of the internal audit department and of the function’s stakeholders (councilors, general managers). We also interviewed the leader of the Internal Audit function at five other municipalities and reviewed the practices that they employ in the fulfillment of the internal audit mandate.

Our work identified at both the council and senior management levels that there is an appreciation for the need for a robust and effective internal audit function and that the function can provide a positive value for money equation.

The key messages as a result of this review are:

- Improvement is needed in fulfilling the mandate of an audit committee oversight
- Improvement is needed in how the Internal Audit function is performed.

We found that the City of Hamilton internal audit function is intent on performing effectively for the City and its stakeholders. However the work is currently not conducted at a level needed by the City given its breadth and complexity. This is due to resourcing challenges for the function,

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improvements needed to methodology employed by the function as well as the way the function provides information to the key stakeholders of its work.

The Director Audit Services acknowledged that there are some improvements that the function could make. Given the willingness and openness to share information and techniques amongst internal audit functions from other municipalities, we believe that there is great benefit to be gained by having Hamilton's staff make visits to see the best practices in operation at other comparable internal audit functions and learn how to deploy the techniques in the Hamilton environment.

The review resulted in a number of individual recommendations to not only improve the operating techniques of the internal audit function but also to improve the governance oversight of the control environment and the focus on controls with the purpose of safeguarding the City assets, ensuring the City complies with laws, ensuring there is integrity to financial and management reporting and providing for efficiency and effectiveness of operations.

The significant recommendations include the following:

- Improve the conduct of the duties of what is expected of oversight by an Audit Committee (currently performed by the Strategic Planning & Budget Committee) by re-assigning the duties to an appropriate governance level committee;
- Provide specialized training at the start of each council term for the members of the standing committee which has been assigned the responsibilities of an Audit Committee function;
- Provide training to the Internal Audit department now on a risk-based methodology and risk-based reports accompanied by the audit staff visiting municipalities which have internal audit best practices in place;
- Formalize the scope of the Internal Audit function to cover all City operations and services whether conducted directly by the City or through subsidiaries and agencies and improve the function's mandate by including operational auditing;
- Improve the quality of reports from the Internal Audit function including reporting on the 'audit universe' (the audit universe is a summary of the departments, functions and processes of the City), providing context and risk weightings for issues noted, providing conclusions on the effectiveness of controls and formalizing the frequency of reporting (quarterly and annually);

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- Develop a position description for the City Manager role and include in it the position's responsibility vis a vis internal audit, the control environment, and performance of controls as well as improve the position description for general managers to clarify their responsibility for designing and implementing the necessary controls in relation to risks of their department's services and structures;
- Improve the planning conducted by the Internal Audit function at the enterprise level by identifying and risk weighting the 'audit universe';
- Provide additional resources to the Internal Audit function to enable them to cover the breadth and complexity of the City through two additional audit personnel, equipment and financial resources to engage necessary specialist skills when required;
- Improve the approach to the audits through teaming the auditors and communicating with the auditees during the audits;
- Internal Audit conduct a self-assessment of its practices against the professional standards as advanced by the Institute of Internal Auditors.

It will do the City well to invest in the Internal Audit function and the return will be seen in the identification of improvement to city operations (improved efficiency, decrease in costs), the deterrence of fraud, and better information to enable Council to set the proper tone for the City's operations and to provide effective oversight.

Introduction

The City of Hamilton (“the City”) is the ninth largest city in Canada, with an annual budget (capital and operating) in excess of \$1 billion, over 6,200 staff, and accountability to over 500,000 citizens. City Council and City Staff are expected to operate the city to efficiently and effectively deliver the services needed by the citizenship. Council and staff’s responsibilities also extend to ensuring the safeguarding of the city’s assets, ensuring the city complies with laws, and ensuring integrity of reporting of information and results to the citizens as well as to other funders. This is clearly a significant and onerous responsibility on the shoulders of the elected officials and the senior management team.

Council must rely on the senior management team and other staff to enact processes and practices necessary to deliver the services and to ensure the protection of people and property. Given the breadth of the responsibilities, the size of the operations, and significance of services, it is important that there be proper checks and balances within the organization to provide for sound and prudent business and financial practices. Large and complex organizations need proper infrastructure and robust processes to provide for a strong control environment. One important element of a robust system in large organizations and which Council can rely on to provide objective views on the management of funds and operations is a strong Internal Audit function.

The City through its predecessor municipalities has had an internal audit function for a number of years. However with the amalgamation creating such a large municipality there has been a significant escalation in the needs from, and demands on, the function. Over the past few years, questions have been raised about the adequacy of the control environment at the City. The control environment and the tone of control is generally demonstrated by the strength of oversight by the governance level. The strength of governance oversight is dependent on a variety of elements such as codes of conduct, competency of people, and strength of processes. There are two key elements that can support the governance oversight of the control environment as well as assist the governing body to execute its role in the control environment:

- Effective structure and practices of an Audit Committee
- Effective structure and practices of the Internal Audit function.

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While these two are intertwined, a strong Internal Audit function can greatly assist the Audit Committee in how it develops and executes on its responsibilities. Because of its unique position, Internal Audit is in an excellent position to positively influence and support governance, risk management, and soundness of operations of an organization.

As a result of recent concerns expressed by the City's financial auditors regarding the strength of the internal control environment and the resources of the Internal Audit function, the City decided to undertake a review of the Internal Audit function. The review commissioned also requested that consideration be given to what service the Internal Audit function could and should be providing to the City.

The City of Hamilton's Internal Audit division is comprised of five staff, the Director, one senior internal auditor, two intermediate internal auditors and an administrative assistant. The annual budget for the department is approximately \$500,000.

The City's review of the Internal Audit function is consistent with work recently undertaken by other cities. In 2000 the Office of the Auditor for the City of Edmonton underwent an external review to determine how it could better serve the needs of the City of Edmonton. Since 2002, three additional cities, Ottawa, Toronto, and Calgary, have reviewed their functions. A consistent message is that Internal Audit is a critical component to a well functioning public body but the function needs to be properly structured and resourced to deliver on the expectations. It is also important that the office have functional and organizational independence from Administration. This independence is critical to ensuring that audit findings, opinions, conclusions, judgments and recommendations are impartial, and are viewed by others as impartial. The reviews also examined the sufficiency and appropriateness of the mandate of the function. There are valuable learnings that can be derived from the work already undertaken by these other municipalities.

The Institute of Internal Auditors (IIA) has issued the following definition: *“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.”*¹ The IIA's International Standards for the Professional

¹ Institute of Internal Auditors website; www.theiia.org

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Practice of Internal Auditing (Standards) specify that the chief audit executive establish risk-based plans to determine the priorities of the internal audit activity, consistent with the organization's goals.

It is within this context and with reference to other experiences that the review of the City of Hamilton's Internal Audit function was undertaken.

Objectives

The City stated the following purposes for the review of its Internal Audit function:

- a) Conduct a high-level operational and administrative review of the Internal Audit Division.
- b) Capture the roles that the Internal Audit Division could provide and the resources required to perform them.
- c) Recommend opportunities for improvement based on best practices in public Internal Audit operations and Public Internal Audit administration considering performance and attribute standards as set by the Institute of Internal Auditors.
- d) Recommend options for a strategic work plan for implementing the opportunities identified above.
- e) Provide an education and awareness initiative for management and members of Council.
- f) Complete and present a report to the Corporate Management Team (CMT) and City Council members.

Methodology

The consultant team utilized a five phase work plan to perform the review of the City's Internal Audit Function. The steps were designed to gather information from different sources to enable the review to adequately evaluate the current practices of the function and the roles that the function could provide. The techniques utilized included the review of key documents, interviews with Councilors, senior management, and internal audit staff as well as interviews with comparators and reviews of their documents.

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The five phases of the work plan included the following:

- Phase 1 Initial Planning and Orientation – initial meeting with City project liaison to review process, outline involvement and assistance and information needed from the City.
- Phase 2 Data Gathering on Existing Function and Needs of Stakeholders – gathered data on operations of Internal Audit through means such as interviews and document review.
- Phase 3 Compilation of Best Practices Relevant to the City – compile information on internal audit functions at five comparable municipalities.
- Phase 4 Analysis of Information and Development of Recommendations – assess information gathered, develop recommendations.
- Phase 5 Reporting and Presentations – prepare draft report, vet, and issue the final.

City documents reviewed consisted of the following:

- By-law No. 03-301, By-law to Govern Proceedings of Council and Committees of Council
- City of Hamilton Vision, Mission, Values and Goals Statement
- Internal Audit Mandate (undated, estimated to be from 2002)
- Audit Committee Sub-Committee Terms of Reference (undated, estimated to be 2002)
- Organization charts for functions, department, and persons reporting to the City Manager
- Job Descriptions for City Manager, Departmental Managers, Internal Audit staff
- Reports from Director Audit Services to the Strategic Planning and Budgets Committee
- Working paper files supporting reports issued by Internal Audit.

Interviews were held with councilors and staff within the City as listed in Exhibit I. Customized questionnaires were developed for use in each of the interviews with the questions focused on the person’s level as a stakeholder to the work of Internal Audit or as a member of the function.

EXHIBIT I: LIST OF PERSONS INTERVIEWED AT CITY OF HAMILTON

Person	Title
Councilors	
Mayor Larry DiIanni	Chair of Strategic Planning & Budget Committee
Terry Whitehead	Chair of Planning & Economic Development Committee, Member Strategic Planning & Budget Committee
Phil Bruckler	Chair of Community Services Committee, Member Strategic Planning & Budget Committee
Brian McHattie	Chair of Social and Public Health Committee, Member Strategic Planning & Budget Committee

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Dave Braden	Chair Corporate Administration, Member Strategic Planning & Budget Committee
Bob Bratina	Member Social & Public Health Committee

City Management

Glen Peace	City Manager
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General Managers

LeeAnn Coveyduck	Planning & Development
Catherine Graham	Human Resources
Joe-Anne Priel	Public Health & Community Services
Joe Rinaldo	Finance & Corporate Services
Scott Stewart	Public Works
Jim Kay	Emergency Services

Internal Audit Staff

Ann Pekaruk	Director, Audit Services
Debbie Thomas	Administrative Assistant II
Karen Cinq-Mars	Senior Internal Auditor
Domenic Pelligrini	Intermediate Internal Auditor
Gershom Moyo	Intermediate Internal Auditor

Interviews were also held with a senior person from the Internal Audit function at five comparator municipalities. Those interviewed are listed in Exhibit II. The focus of the interviews was on the practices utilized in the conduct of the internal audit work and the reporting structure for the function within the municipality.

EXHIBIT II: PERSONS INTERVIEWED AT COMPARATOR CITIES

Person	Title
Shannon Hunt	City Auditor, City of Winnipeg
Bill Cook	Director of Audits & Administration, City of Edmonton
Alain Lalonde	Auditor General, City of Ottawa
Paul Duggan	Director, Audit Services, Region of York
Don Ikeno	Senior Manager, Management Support & Audit Services, City of London

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Current Environment of the Internal Audit Function**

CURRENT ENVIRONMENT OF THE INTERNAL AUDIT FUNCTION

Mandates

In order to have an effective internal audit group the following elements need to be in place:

- A mandate that provides for the proper approach and authority for the work
- A structure that provides for objectivity and independence of the function
- Resources, both people and processes, sufficient to deliver on the scope of the function and provide value added information for management and to enable the governance level.

Key documents that guide the Internal Audit (“IA”) function is its mandate and the terms of reference for the Audit Committee. The mandate for the City’s IA function was approved in 2002. Given the importance of the mandate of the internal audit function, it should be reviewed and updated at least every three years, reviewed and approved by council. This should be conducted in alignment with the start of the term of council.

Internal Audit Mandate

The mission of the Internal Audit contained in the mandate states:

“The mission of the Internal Auditing Division is to provide independent, objective assurance and consulting services designed to add value and improve the organization’s operations. It helps the organization accomplish its objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, control and governance processes.”

This is an appropriate mission for the function. The mandate contains the appropriate elements of scope of the function, independence, authority, responsibilities, audit program, and standards of audit practice. Exhibit III contains the full mandate of the City’s Internal Audit provided to us. We understand that there have been some changes made to the reporting lines for the Internal Audit function since the mandate was developed. However these changes have yet to be reflected in an updated mandate document.

We reviewed the mandate in place for other municipalities and this is discussed further in the best practices section of the report.

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EXHIBIT III: INTERNAL AUDIT MANDATE CURRENTLY IN PLACE

A. MISSION AND SCOPE

The mission of the Internal Auditing Division is to provide independent, objective assurance and consulting services designed to add value and improve the organization's operations. It helps the organization accomplish its objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, control and governance processes.

The scope of work of the Internal Auditing Division is to determine whether the City's network of risk management, control and governance processes, as designed and represented by management, is adequate and functioning in a manner to ensure:

- Risks are appropriately identified and managed.
- Significant financial, managerial and operating information is accurate, reliable and timely.
- Council's and employees' actions are in compliance with policies, standards, procedures and applicable laws and regulations.
- Resources are acquired economically, used efficiently and are adequately protected.
- Programs, plans and objectives are achieved.
- Quality and continuous improvement are fostered in the organization's control processes.

Internal Audit provides management with information to assist in the control of operations for which it is responsible. Opportunities for improving control and the organization's image are identified during audits. These are communicated to the appropriate level of management.

B. INDEPENDENCE

Independence is an essential component to building public trust and preserving objectivity and integrity associated with the audit function.

To provide for the independence of the Internal Auditing division, its personnel report to the Director of Audit Services, who reports functionally to the Executive Director of Corporate Secretariat. Audit and review reports are sent directly to the Audit Sub-Committee for discussion and approval. The Audit Sub-Committee reports to the Committee of the Whole (COW). As such, the audit reporting process becomes a way to enhance Internal Audit's credibility.

Internal Audit will not engage in activities that it would normally review and appraise, and thus, could appear as a compromise to Internal Audit's objectivity.

C. AUTHORITY

Internal Audit staff are authorized to:

- Have unrestricted access to all functions, records, property and personnel determined relevant to the performance of audits. This access is provided under The Protection of Privacy Act – Municipal Freedom of Information (in particular, Sections 31(c) and 32(d)).
- Allocate resources, set frequencies, select subjects, determine scope of work, and apply the techniques required to accomplish audit objectives.
- Obtain the necessary assistance of personnel in departments/divisions/section of the organizations where audits are performed, as well as other specialized services from within or outside the organization.

D. RESPONSIBILITIES

The Director of Audit Services and the staff of the Internal Audit Division have the responsibility to:

- Review operations within the City at appropriate intervals to determine whether planning, organizing, directing and controlling are in accordance with management instructions, policies and

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procedures and in a manner that is consistent with both City objectives and high standards of administrative practice.

- Determine the adequacy and effectiveness of the systems of internal accounting, financial and operating controls.
- Review the reliability, utility and integrity of financial information and the means used to identify, measure, classify and report such information.
- Review the established systems to ensure compliance with those policies, plans, procedures, laws and regulations which would have a significant impact on operations and reports and determine whether the organization is in compliance.
- Review the means of safeguarding assets and, as appropriate, verify the existence of such assets.
- Report to those members of management who should be informed or who should take corrective action, the results of audit examinations, the audit opinions formed, and the recommendations made.
- Evaluate any plans or actions taken to correct reported conditions and provide timely follow-up to ensure satisfactory disposition of audit findings in the manner and timeframe committed to by management in the original audit report. If the corrective action is considered unsatisfactory, hold further discussions to achieve acceptable disposition.
- Develop a flexible annual audit plan, including any risks or control concerns identified by management or other audits as well as appropriate special tasks or projects requested by management.
- Maintain a professional audit staff with sufficient knowledge, skills and experience.
- Evaluate and assess significant new or changing services, processes, operations or control processes coincident with their development, implementation and/or expansion, especially in the area of Information Technology (IT).

E. AUDIT PROGRAM

I. The Annual Plan

Each year, the Internal Auditor prepares a work plan, setting out the proposed schedule of audits and other undertakings proposed for the coming year. In order to generate this plan, the following sources are used:

1. requests from the City Manager, the General Managers and Executive Directors;
2. judgment, risk-based, budget-based factors
3. any audits that had been planned for the last year, but were delayed or not completed;
4. any conditions or concerns that have been discovered or communicated throughout the past year.

The annual plan is presented to the Committee of the Whole for approval.

II. Follow-up Program

Internal audit is responsible for seeing that all reported weaknesses or deficiencies are corrected. Coupled with this responsibility is the authority to evaluate the corrective action taken. The Internal Audit section is not responsible and has no authority to take corrective action. This is management's responsibility. However, Internal Audit is responsible for determining whether the action taken will address the weaknesses or deficiencies.

It is anticipated that, on the average, audit reports will be followed-up within the next immediate 18 months to two years following their original issuance.

F. STANDARDS OF AUDIT PRACTICE

Internal Audit will be guided by the Standards for the Professional practice of Internal Auditing of the Institute of Internal Auditors.

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The mandate is well composed and we recommend only a few changes:

- state the types of services that the internal audit group will carry out
- include in the scope of the function that the scope is comprehensive and covers all City operations whether offered directly or through subsidiaries or agencies
- include in scope that the function will use a risk based approach in the conduct of its work
- add to responsibilities:
 - perform special assignments at the request of the Audit Committee or by request of the City Manager (which are to be post approved by the Audit Committee)
- add a section on reporting out and include the following items:
 - the Director will formally present the risk rated audit universe (the audit universe is an outline of the departments, functions and processes which comprise the operations of the City) and the process for developing the audit plan for the current year to the Audit Committee on an annual basis
 - the Director will formally report to the Audit Committee on a quarterly basis on the system of internal control as evidenced from the conduct and results of audits and the trends across the City
 - the Director will formally report to the Audit Committee on a quarterly basis on the performance of the Internal Audit department, its progress against plan, reasons for any variance and action proposed
 - the Director will present a risk-based annual plan to the Audit Committee and an outline of what is being included in a multi-year plan
- amend the follow-up program duties to: Internal Audit is responsible for seeing that ‘significant’ reported weaknesses or deficiencies are corrected (this is to change the word ‘all’ to ‘significant’). Also consider that management is responsible for seeing that problems are corrected and to report status to the Audit Committee. Internal Audit should monitor and report management’s progress for significant items.

There are interesting approaches taken by other municipalities and in particular we reference the City of Edmonton, bylaw 12424 entitled City Auditor November 2002. The City of Hamilton should review the approach taken by Edmonton and adopt certain of the ideas from that bylaw.

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Recommendations

- Update the Internal Audit mandate for the changes in reporting lines and for omissions as noted and have it reviewed and approved by Council.
- Ensure the mandate is reviewed and updated and taken for approval to Council at the commencement of a new council term.

Audit Committee

The terms of reference for the Audit Sub-Committee were developed in 2002. This predates the current committee structure that the City currently operates with. In 2003, by-law 03-301 a by-law to govern the proceedings of Council and Committees of Council was established. Through this by-law the following committees were established:

- Community Services
- Corporate Administration
- Planning & Economic Development
- Public Works, Infrastructure & Environment
- Social & Public Health Services
- Strategic Planning & Budgets.

An Audit Committee was not established as part of this new structure introduced in 2003 but one of the items included in the mandate in Appendix F, Strategic Planning & Budgets Committee was to report and make recommendations to Council on matters relating to internal/external audits. Specific duties include *“To consider and recommend to Council all audit matters, including promoting an appropriate environment for the management of public funds and a high level of accountability. Ensure compliance with laws, regulations, policies and support high standard of ethical conduct.”*

The Audit Sub-Committee terms of reference from 2002 were more detailed. The purpose, objectives and roles and responsibilities are summarized in Exhibit IV.

The Strategic Planning & Budget (SP&B) Committee assumed the role of the Audit Committee in 2003. As a result, the Internal Audit function now submits reports to the SP&B Committee whenever an individual audit is completed. Through our interviews, there were issues identified

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with the reporting line to the SP&B Committee and the committee's execution of its assigned Audit Committee responsibilities.

The SP&B committee consists of a representative of each of the 5 standing committees which in practice has been the chair of each committee. Since the committee chairs are limited to a one year term, there is frequent turnover of the SP&B Committee. The lack of continuity makes it difficult to effectively train the committee members in the nature of the services of the Internal Audit function, how to interpret the information and results provided by Internal Audit, and direct management in resolution of issues.

EXHIBIT IV: TERMS OF REFERENCE FOR AUDIT SUB-COMMITTEE SET IN 2002

PURPOSE

The Audit Sub-Committee's principal role is to ensure that due diligence has been directed towards ensuring that an effective control framework has been implemented by management. This framework provides reasonable assurance that the financial, operations and regulatory objectives of the City are achieved and that the governance and accountability responsibilities of council and management are met. The Audit Sub-Committee fulfils its role on behalf of City Council.

The Audit Sub-Committee normally undertakes, on behalf of council, responsibility for the oversight of internal control, financial reporting, and compliance with approved policies and procedures.

OBJECTIVES

The objectives of the Audit Sub-Committee are:

- To help Council fulfill its oversight responsibilities, including the accountable management of public funds, the economy, efficiency and effectiveness of operations, and the safeguarding of assets from loss;
- To ensure compliance with policies and procedures;
- To ensure reliability of external and internal reporting;
- To strengthen the independence of the audit function by providing a forum for communicating findings to Council and facilitating the audit functions independence from management;
- To communicate the concerns of City Council to the auditors and to have input into the overall direction of audit efforts; and
- To promote effective and timely resolution of audit issues.

ORGANIZATION

The Audit Sub-Committee will be comprised of six (6) members of Council and the Mayor. Members will be appointed for the term of Council. The chairperson of the Sub-Committee will be nominated and approved at the first Sub-Committee meeting in the term of the current Council.

The Audit Sub-Committee shall meet not less than two (2) times a year to coincide with the stages of the external audit. Special meetings may be convened at the discretion of the Chair. The External Auditors or the Internal Auditor can also request a meeting of the Sub-Committee. A quorum for any meeting will be four (4) members. The Internal Auditor, the External Auditor, the City Manager, and any other staff deemed necessary shall also attend the meetings.

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ROLES AND RESPONSIBILITIES

Control Framework

The Audit Sub-Committee obtains assurance that the elements of control (resources, systems, processes, structure and tasks) are in place to achieve the organization's goals and objectives. The Audit Sub-Committee:

- Ensures that corporate activities are managed with an appropriate degree of care and due diligence and within an appropriate framework of ethics and control;
- Obtains assurances that the City has policies and procedures which are in compliance with legal, regulatory, ethical and environmental requirements;
- Reviews policies and procedures that safeguard City assets with management, the External and Internal auditors;
- Ensures that the City has implemented appropriate internal controls systems over financial reporting and that these are operating effectively; and
- Understands the risks associated with the type of services that the City provides and ensures that the appropriate means are in place to manage these risks.

Internal Audit Division

The Audit Sub-Committee:

- Approves the Internal Audit mandate;
- Confirms the work plan of the Internal Audit Division;
- Receives and reviews the results of all audits and follow-up reviews to ensure appropriate action has been taken (necessary for the effective oversight of the internal control framework and culture);
- Ensures the Director of Audit Services has direct and open communication with the Sub-Committee;
- Ensures that the internal auditors are not restricted or impeded in the conduct of their responsibility by other personnel of the City;
- Approves the Internal Auditor undertaking value-for-money process audits on an as-required basis.

External Auditors

The Audit Sub-Committee:

- Recommends to Council the appointment of the External Auditor to a five year or lesser term contract;
- Approves the External Auditor's annual fees. In addition, the nature of and fees for other services that have been provided by the External Auditor are reviewed annually (which provides assurance as to the independence of the External Auditor);
- Discusses the scope and timing of the audit work with the External Auditor with particular reference to high risk areas;
- Received and reviews the annual audited financial statements and management letters, makes inquiries of management and the auditors and forwards them to Council for approval;
- Provides a scheduled opportunity to meet with the External Auditor for full, frank and timely discussions of all material issues, with or without management, as appropriate in the circumstances;
- Reviews and approves the policies used for the City's financial reporting; and
- Reviews and approves the methodology of determining provisions and adequacy thereof.

TERMS OF REFERENCE

These Terms of Reference are based on a review of contemporary audit committee best practices and current literature.

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There are two options that could be pursued to improve the governance oversight.

1. Strike an Audit Committee as a standing committee.
2. Delegate the Audit Committee duties to an appropriate standing committee where the committee has the appropriate mandate to provide the time and attention to the control environment and audit issues (this committee may not exist in the current Council committee structure).

There are advantages and disadvantages for each of these options.

In establishing an Audit Committee as a standing committee there results a committee with a singular focus on audit issues. This committee could oversee both the external and internal auditors. However a single focus on internal and external audit sometimes results in items being dealt with out of context.

We note that the City's external auditors in its report to the SP&B Committee on June 22, 2005, item 7.2 recommended three ways for the City to ensure that it "*remains fiscally responsible.*" The firm stated that it "*therefore becomes increasingly important to have members of the SP&B committee with financial expertise to be able to effectively analyze and interpret financial information presented, and ask relevant questions to properly understand the data.*" The firm presents three ways the SP&B committee can obtain this expertise:

- a. Formal education sessions for current committee members on financial reporting.*
- b. Supplementing the SP&B committee with members of the community with demonstrated financial reporting skills.*
- c. Establishment of an audit committee, separate from the SP&B committee, with a mandate to oversee the external audit and financial reporting of the City. This committee would be comprised only of members with demonstrated financial expertise, either with community members or with a mix of community members and councilors."*

The focus presented by the external auditors is on financial reporting. The mandate of the Audit Committee encompasses a broader responsibility than just financial reporting. Oversight of the audit function that the governance level should be providing and be accountable for is to ensure the appropriate control environment and internal controls are in place for four objectives:

- Safeguarding of assets
- Reliability of financial and management information

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- Compliance with laws and regulations
- Efficiency and effectiveness of operations

Note that reliability of financial information is only one item in this list. If the Committee were to focus too much on the financial literacy part, it would not be fulfilling the full mandate that people have come to expect of a governing level.

While representatives from the community are valuable contributors to ad hoc committees that have a specific focus we would caution the City on introducing members of the community on a standing committee. Given the unrestricted nature of the work of the Audit Committee, the matters are very extensive and could allow an unelected official to have access to more information than the taxpayer would expect of someone who has no accountability to the electorate.

While there has been much discussion of the need for financial literacy of audit committee members, in the public sector this should not be a restriction for committee members. Generally elected officials understand the need for judicious control over spending. Their duties include learning and understanding the budget process, the variance analysis during the year, culminating in the year end reporting. Many councilors adequately learn this over their years of experience.

One of the rules that was introduced in the post Sarbanes-Oxley world, is to prohibit the Chair and Vice Chair of the Board from being on the Audit Committee. If one were to equate the chair of the Board to the mayor's position, then the SP&B committee would run afoul of this rule given that the Chair of the SP&B committee is the mayor and the SP&B acts as the Audit Committee.

The challenge with the SP&B committee is that only when the members of the committee have been operating with some momentum there is a change in membership. As noted procedural by-law 03-301, paragraph 5.2 (2) states that terms of the Chair and Vice Chair of Standing Committees will be one year. With the practice that the Chairs of the standing committees are the representative to the SP&B, there is an annual wholesale changeover of SP&B membership (excluding the mayor).

The City had an Audit Committee in the past (prior to 2003). The conduct of these meetings was difficult on a regular basis. The Committee was expected to meet at least twice a year but getting

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quorum for the meetings was an ongoing challenge. Also there was no flow to the proceedings given the infrequent meetings, the lack of quorum, compounded by a schedule of meeting only twice each year.

Rather than add another committee it would be advantageous to use the existing committee structure, reconfigure existing committees, or establish a new standing committee to provide for effective performance of oversight for the 'in-control' status of the City.

In assigning the Audit Committee duties to an oversight committee, there should be synergies with other responsibilities across the City so that the committee does not have a singular focus on just Audit. In some organizations there is a Finance and Audit Committee or a Finance and Risk Management Committee that would be the vehicle for oversight. This committee should be established for the term of council. In addition the members of the committee should receive focused training on the role of internal and external audit (including the differences between the two), the internal audit function's responsibilities, how the internal audit work is executed, the 'audit universe' and its risk weighting and how the internal audit plan is developed based on the risk weightings.

The terms of reference for the Audit Committee function should be updated now and thereafter updated at least every three years concurrent with the start of a new council term. We recommend that the terms of reference be updated now and the duties can then be assigned to the appropriate oversight committee.

Overall the Audit Sub-Committee terms of reference from 2002 are well composed and the only changes that we recommend at this time include the following:

- recognize in the purpose that the role of the committee includes ensuring that there is an effective risk management and internal control framework (internal controls without reference to risks may be an undue burden)
- require that the committee meet at least four times a year; and have the mayor as ex-officio rather than a committee member
- add responsibilities regarding internal audit as follows:
 - reviews, approves the updated mandate of internal audit every three years;

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- approve (rather than confirm) the annual work plan while ensuring that the effort is reflective of the risk profile of the City;
 - confirm that Internal Audit deploys a risk based methodology in the conduct of its work;
 - receive quarterly and annual reports from Internal Audit on its assessment of the system of internal control within each unit and across the City and trends of improvement or weakness evident from Internal Audit's work
 - ensures proper resourcing of Internal Audit to enable it to execute on its mandate including staff and financial resources
- add a section of responsibilities for financial reporting and add/include duties as follows:
- Reviews and approves accounting policies used for financial reporting including any significant changes from year to year
 - Reviews and approves management's methodology of determining financial provisions and adequacy thereof
 - Ensures that effective process is in place, including having appropriate internal controls, providing reasonable assurance that financial reporting has integrity and provides reliable and fairly presented financial statements
 - Receives, reviews audited financial statements, recommends to Council
 - Reviews reports containing financial information for distribution to the general public and approves such before distribution
 - Receives and reviews financial statements of material subsidiaries
 - Receives reports from management regarding compliance with financial regulatory requirements and other legislative financial compliance²
- Under the section entitled External Auditors, add
- Sets the policy for the engagement of the external auditor for the conduct of other services. In addition, pre-approves the nature of, and fees for, other services that can be provided by the external auditor; and annually reviews the nature of and fees incurred for other services.

² Such as employee withholding payments, tax remittances

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Recommendation

- Update the duties of the Audit Committee function as outlined in the report.
- Have Council formally re-assign the duties of the Audit Committee to an appropriate standing committee that has the appropriate focus and breadth of responsibility.
- Provide training/orientation for the members of the standing committee on what is involved in performing the duties of an Audit Committee and provide this same training/orientation at the beginning of each council term.

The new oversight committee should establish a schedule of meetings at which time they will function as the Audit Committee with the purpose of dealing with its audit committee duties. A schedule of meetings and tasks for the meetings could be organized as displayed in Exhibit V.

EXHIBIT V: AUDIT COMMITTEE SCHEDULE OF MEETINGS AND TASKS

Task	Jan	April	July	Oct
Control Framework				
Receive report on new regulatory requirements				✓
Enquire of internal audit as to any restrictions on their work	✓	✓	✓	✓
Review any policies brought forward by management	✓	✓	✓	✓
Financial Reporting				
Receive from management an update of changes to accounting policies along with rationale				✓
Receive report from management on methodology for provision				✓
Review audited financial statements, recommend to Council		✓		
Receive financial statements from material subsidiaries		✓		
Receive and review a report on financial information disclosed to the general public, and the process to ensure integrity of such				✓
Receive report from management on compliance with financial regulatory requirements	✓			
Internal Audit Function				
Review Internal Audit's annual and multi-year work plans, ensuring a risk based approach and appropriate allocation of resources	✓			
Receive report from Internal Audit on resourcing for function	✓			
Receive reports on progress on plan, Internal Audit's view of internal controls and management of risks	✓	✓	✓	✓
Receive report from management on resolution of Internal Audit findings from prior reports	✓	✓	✓	✓
External Auditor				
Receive outline of scope from external auditor				✓
Consider fee estimate from external auditor				✓
Update policy for engaging external auditor for other services			✓	
Review fees for audit and other services from external audit		✓		✓
Assess independence of external audit firm		✓		✓
Review management letter from external audit firm			✓	
Enquire into conflicts between external auditor & management		✓		✓
Appoint/annual evaluation of external audit firm			✓	

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Recommendation

- Establish at the beginning of each year, dates once per fiscal quarter that the oversight committee will conduct its Audit Committee duties (e.g. April, July, October, and January – these being one month after the quarter end).
- Ensure that the Internal Audit formally reports at each of the quarterly Audit Committee meetings and the External Audit formally reports twice per year (at the planning stage of the audit and at completion).
- In each quarterly report to the Audit Committee the Director Audit Services should specifically state if there have been any impairments to the execution of the audit work.

Organization Structure and Positioning

The current Internal Audit mandate states that the function reports functionally to the Executive Director of Corporate Secretariat. In the current Audit Sub-Committee terms of reference, it states “*Audit Sub-Committee ensures that the Director of Audit Services has direct and open communication with the sub-committee.*” The organization chart for the City Manager’s Office dated April 15, 2005 shows the Director, Audit Services as a direct report to the City Manager.

The Director, Audit Services role description states: “*Reporting to the City Manager provides strategic leadership to a specialized workforce engaged in the analysis of services and recommendations of improved methods, systems or techniques to support the delivery and integrity of services to the Corporation and the public.*” There is no other reporting relationship identified in the document.

One of the critical elements for the proper functioning of internal audit is for it to operate independently and objectively. The independence and objective state is achieved through two means: one is to be free of decision making as it relates to the establishment of policy and procedures in the operations of the organization; the other is to have independence provided through reporting lines. Accepted practice is for the head of the internal audit function to have two reporting lines. One reporting line should be to the governance level directly and the other to a senior management position, i.e. City Manager, for administrative purposes.

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Recommendation

- Update the position description for the Director Audit Services to reflect dual reporting lines – administratively to the City Manager, and direct reporting and access to the governance level for the conduct of the Internal Audit work.
- Update the mandate of the internal audit function to reflect the dual reporting lines.

In requesting the position description for the City Manager in order to determine the position's responsibility vis a vis Internal Audit, we were provided with a job ad for the position and subsequent requests to Human Resources have not been able to produce a position description.

Recommendation:

- Develop a position description for the City Manager role and ensure the responsibilities regarding Internal Audit are clearly articulated and respects that the Director Audit Services has dual reporting lines.

We reviewed the position description for the Director Audit Services to analyze the types of duties expected of the Director. The summary of duties includes *“Performs independent reviews and evaluations of all significant activities throughout the corporation in order to establish that these activities are executed in compliance with prescribed policies and procedures.”* This duty is appropriate although it is restrictive in its scope in that the focus is on complying with policy but does not permit the auditor to first of all consider if the policy is appropriate. There are items included under general duties that are **not** appropriate such as:

- *Participate in strategic planning and direction as a member of the City Manager's office* (the internal audit department needs to be independent of the business planning decisions)
- *Attend public meetings to present the City's positions/actions to the public, media and outside government bodies* (the Director is not generally the spokesperson for the City)
- *Assume responsibility for the preparation of all Corporate Effectiveness reports and provision of information and assistance to departments* (the Director needs to be independent of the business so should not be preparing the effectiveness reports)
- *Co-ordinate and advise on managerial accountability for all corporate policies* (co-ordination of policy needs to be handled by management)

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- *Ensure compliance with provincial and federal statutes, regulations and standards and municipal by-laws and policies (it is management’s responsibility to ensure compliance, it is Audit’s responsibility to test it and report on whether it is being performed).*

The position description does not include a clear statement that the Director Audit Services is responsible for ensuring the mandate of the Internal Audit is effectively delivered or supporting the governance level in its responsibilities with respect to the risk management and control environment.

Recommendation

- Update the position description for the Director Audit Services to remove inappropriate duties and to encompass more focus on the evaluation of the control environment, risk management, and control activities including delivering on the Internal Audit mandate and supporting the governance level.

We reviewed the position descriptions for the departmental managers to ascertain their duties in relation to the implementation of controls. There are a few general duties that could suggest that the general managers have responsibility in regards to implementing controls in relation to risk but it is not clearly stated.

Recommendation

- Insert a specific duty in the position description for each general manager the following:
Responsible for ensuring internal controls in the form of policies, procedures and practices are developed and implemented in relation to the general and specific risks of the area and to achieve the objectives of safeguarding City assets; reliability of management and financial information; compliance with laws and regulations; and efficiency and effectiveness of operations; and ensure that the internal controls operate effectively and continuously.

Scope and Approach of Internal Audit

Scope

Generally most Internal Audit functions have unlimited scope across the Corporation. At the City there are some differences of interpretation of the scope for its Internal Audit function. The City’s operations are delivered through direct departments within the City, subsidiaries (e.g. Utilities), and

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agencies. It is unclear if the Internal Audit function includes all within its scope. It is important that all City operations, conducted directly or indirectly, be within the scope of the City's Internal Audit function's mandate. This should even include pension plans operated directly by the City.

Recommendation

The Internal Audit mandate clearly specify that it will include all operations directly or indirectly within the operations of the City, specifically all departments, subsidiaries, controlled organizations and agencies.

Approach

The internal audit department does not have an audit manual setting out its approach to planning the annual program of audits, the audit methodology, sampling techniques, or work steps. However the Director has developed a process that is followed in developing the annual audit plan and the group has developed a common approach to the conduct of audits primarily through direction provided by the Director.

In developing the annual internal audit plan, the Director solicits from the councilors and general managers their views on areas they see as needing some level of audit overview. The Director also considers what she has identified as areas of key risk either due to prior internal audit work and/or her understanding of initiatives across the City.

The annual plan is developed by taking into account what is learned through the submissions from councilors and general managers, the audits that had been planned for the prior year but had not been undertaken, as well as follow up reviews on prior audits completed, and the regular recurring work that Internal Audit undertakes annually. The plan allows 15% of the staff time to be unallocated to provide flexibility for unexpected special assignments that the department is asked to undertake (e.g. investigation of fraud).

As detailed in the Director's report to the Strategic Planning and Budgets Committee dated December 17, 2004 (CM04036), the risk factors that the Director considered in developing the 2005 internal audit plan were as follows (an explanation of each is provided in Exhibit VI):

1. Budget
2. City-Wide Exposure

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3. Departmental Needs
4. Quality of Internal Controls and Audit History
5. Political Sensitivity
6. Current Emphasis
7. Liquidity of Assets
8. Complexity of Operations

EXHIBIT VI: INTERNAL AUDIT RISK FACTORS USED

Potential projects were identified and evaluated using selected risk factors, such as:

- a) Budget – areas that control a large portion of the City’s budget are considered. By scheduling these types of audits and reviews, there is some assurance that spending and custody controls are reviewed.
 - b) City-Wide Exposure – There are various services, functions and activities in the City that either involve high levels of risk to the City through some form of exposure or are a City-wide function affecting all or most departments.
 - c) Council/Departmental Needs – Council and management are given the opportunity to request that audits/reviews addressing their specific areas of concern be scheduled in the annual Internal Audit work plan.
 - d) Quality of Internal Controls and Audit History – Areas or functions with strong internal controls and no significant changes in processes or key personnel pose less of a risk to the organization. The date of the last review in a particular area is also considered.
 - e) Political Sensitivity – Audits that minimize the risk of undesirable or embarrassing events occurring or continuing uncorrected are identified. Sensitivity of operations in not meeting Council and departmental goals and objectives is considered.
 - f) Current Emphasis – Information relating to audit projects conducted in comparable Canadian cities is reviewed in order to ensure current areas of apparent emphasis are considered.
 - g) Liquidity of Assets – Usually, the more liquid (closest to cash) the asset, the greater its susceptibility to misappropriation.
 - h) Complexity of Operations – Consideration is given to the complexity of a particular process or activity – a simple stand alone process to a highly integrated activity with many interfaces. The extent of computerized systems is also weighed.
-

These are good risk factors to consider in evaluating which assignments should be undertaken. However the report does not provide a clear linkage of these eight risk factors and the proposed assignments listed in Appendix A of the December 17, 2004 report.

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Recommendation

- The annual audit plan to provide a clear explanation of why specific audit areas in relation to the risk factors have been selected and present at a high level the scope for each of the audits.

The annual audit plan does not provide an overall audit universe that has been risk evaluated at a high level to demonstrate to the governance level where the greatest degree of risk exists across the City under the various factors. The risk rating of the audit universe does not need to be a complex process. A scale of high, medium, low could be used or a scale of 1 to 5 where 1 represents low risk and 5 represents high risk. In absence of this context, it is difficult for the governance level to know whether the resources are being allocated to the areas of greatest risk and therefore appropriate use of corporate resources for which they are accountable.

Recommendation

- The annual audit plan to present the full audit universe for the City risk rated at a high level across the eight risk factors.

The Internal Audit mandate states “*Each year, the Internal Auditor prepares a work plan,In order to generate this plan,any audits that had been planned for the past year, but were delayed or not completed.*” Audits that are carried forward from the prior year should not get priority simply because they were in the prior year plan and were not conducted. These potential audit units should be evaluated in the context of the current year and should be risk-rated and evaluated as any other audit area.

Recommendation

- The development of the annual audit plan should consider current year risks. It should **not** automatically include audits identified in the prior year and not conducted. The Internal Audit mandate should be updated to reflect this.

There is work that the Audit department has been undertaking on an annual basis including: procurement card usage, business travel, training and other related expense, Police revenues and cash accounts; fair wage policy compliance for contractors and the Red Hill Expressway claim. These items are not subject to a risk evaluation but assumed to take place each year. This may not

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be the best use of the Audit department resources in relation to the overall challenges and priorities for the City. Again this work should not be undertaken unless it has been evaluated according to the risk factors. Also there may be more cost effective ways of having this work done without utilizing the limited internal audit resources.

The development of the annual audit plan is extremely important for the City as this will direct the use of the internal audit resources and also sets in motion the information that will be provided to the governance level. Therefore the development of the plan needs to be adequately robust, challenging of the status quo and clearly identify rationale for the use of specialized and limited resources.

Recommendation

- Risk-evaluate all potential assignments including the regular recurring assignments. Also consider if the regular recurring work should appropriately be owned by management.

The approach taken in the conduct of individual audits should likewise follow a risk-based approach consistent with the City's annual internal audit plan. An evaluation of risk exposures should be performed in the planning stages of the audit and procedures should be designed based on this risk assessment. This helps to ensure that efficient and effective audit work is performed. Documentation of the risk assessment was not clear in the files.

Recommendation

- The Internal Audit function needs focused training on developing the audit universe and the internal audit plan (multi-year and annual), the approach to individual audits, and reporting. We recommend that the City provide focused training for the Internal Audit group as a team on these subjects. The training should be provided by someone knowledgeable of the City's operations as well as the profession of internal auditing. We recommend that the training be executed in three phases, with phase I on site and focused on methodologies and reporting; phase II be comprised of visits by the internal audit staff to other municipalities to see and learn from them; and phase III be the sharing/reviewing of the learnings to develop practices and protocols appropriate for the City of Hamilton.

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In the planning stages of the audit, the auditor relies on guidance from the Director, discussions held during the initial meeting with the auditee, and review of past audit files, if any. Professional associations of municipal government auditors may be contacted, usually via internet, to see if other municipalities have performed similar audits and if audit programs and questionnaires are available. File documentation includes narratives and flowcharts that have been prepared by the auditor. All of this information is then used to design questionnaires and audit tests. The Director approves the work to be performed during the planning stage.

In the initial planning stages, a time budget is prepared by the auditor and approved by the Director. Actual results often differ from the budget, as sometimes additional work is performed during the fieldwork. It should be noted that some auditees mentioned concern regarding scope creep during the fieldwork phase, and the resulting impact on their departmental resources. It is important to discuss changes in scope with the auditee so resources can be allocated appropriately.

In scheduling audits, the Director notifies the auditor about two weeks before the audit is to begin. The auditor contacts the appropriate managers and makes arrangements for initial meetings or for commencement of the fieldwork. Some concern has been expressed by auditees that they do not have enough lead-time to properly allocate resources to answer questions and assist during the audit.

Recommendation

- A regular monthly or quarterly reporting to the City Management Team regarding the status of audit work and upcoming audits should be provided by the Director Audit Services.

Working paper files are very well organized; the work performed and findings are clearly documented.

Upon completion of the fieldwork, findings are summarized and a risk-matrix is prepared with findings rated as low, medium or high risk. A finding is considered reportable if it is of medium or high risk. The risk matrix is a very effective way of presenting the results of the audit work. Using a risk matrix at the planning stages aids in the design of efficient and effective audit tests because the risk level is identified and procedures are only performed for medium and high risk items.

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Audit reports are very detailed and indicate findings together with management's plan for correction. When management receives an audit report, there is a firm timeline for response which is now enforced. This has helped to improve the timeliness of reporting.

Recommendation

- Following the development of the practices and protocols specific to the City of Hamilton, the Director Audit Services can prepare and present these to the Audit Committee and Corporate Management Team for their awareness and understanding.

Resources and Skill Sets

The staff of the function are well credentialed. The designations held by the staff within the department include:

- Chartered Accountant (CA)
- Certified Internal Auditor (CIA)
- Certified Fraud Examiner (CFE)
- Masters of Business Administration (MBA)
- Certified Management Accountant (CMA)
- Certified General Accountant (CGA)

The nature of the internal audit work requires the staff to work in various city locations. While there is a need to have office space for the staff when they are not 'in the field' there is also a need for them to have the appropriate equipment to be efficient and effective in the conduct of their work when at the work site of the auditee. One of the important tools for the auditors in today's working environment is a computer. Most of the internal audit work is completed by using various computer programs and as such the majority of internal auditors at all companies are now equipped with a lap top computer that is portable to move with them from work site to work site. However the City's audit department only has one lap top computer that is shared among the three field auditors. It is rare that there is a free desk top computer at the auditee's worksite that can be provided to the internal auditor to use for the weeks of field work. While one person can be functional with the lap top, the others must conduct their work in the field and then transcribe it to the computer back at the office. This creates an inefficient work process.

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Recommendation

- Each internal auditor be equipped with a City owned lap top with the Microsoft suite of products and the data interrogation package which the audit group uses.

The City is a very complex organization and it offers some specialized services to its stakeholders. As a result, the City has staff with specialized skills such as engineers, computer technical services, legal, and health degrees. In order to conduct effective internal audit work in some of these areas, the audit department would need to have access to similar skills but ones that are independent and objective of the operations being audited. While the audit department has specialized skills in internal auditing and in fraud investigations, the staff do not have other degrees or work experience such as engineering, health, information technology. In addition the budget for the audit department does not include any allowance for the hiring of consultant to supplement the audit staff. As a result, the audit department is not able to competently undertake certain audit work in areas that are high risk for the City. This may cause the audit department to avoid conducting work in areas actually needing some audit attention.

Recommendation

- Provide an annual consulting budget for Internal Audit to engage specialist skills to work under the direction of the Director Internal Audit for the purposes of completing internal audit work.

The audit department has good continuity of its audit staff, although attracting and retaining employees with the Certified Information Systems Auditor (CISA) designation has been difficult. Currently, the department lacks a CISA. Exhibit VII presents the years of service that each of the audit staff have with the City’s audit department.

EXHIBIT VII: YEARS OF EXPERIENCE OF STAFF AT THE CITY INTERNAL AUDIT GROUP

Director	18 years (previously headed Internal Audit department at a private sector company and worked as auditor and accountant for approximately 10 years)
Senior Auditor	4 years (previously in Internal Audit and Finance departments at a private sector company for approximately 6 years)
Intermediate Auditor	6 years (previously on staff with City’s Finance department for approximately 10 years)
Intermediate Auditor	1 year (previously on contract with City’s Finance department for approximately 3 years)
Administrative Assistant	3 years (on staff in various City departments for approximately 21 years).

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We did learn through interviews with City staff and with audit departments in other municipalities that it is difficult to retain staff at the Senior Internal Auditor level. Given the post Sarbanes-Oxley world, there is a tremendous demand for auditors to assist in the new governance requirements in the private sector. As a result the market has forced salaries to increase and it is a greater challenge to recruit and retain auditors. We were provided with the results of an informal salary survey for audit positions of internal audit departments for eight municipalities and one related municipal sector organization³. The ranges for City of Hamilton's positions seemed to be comparable with the other municipalities. However there is a gap within the City's ranges itself. There is an overlap at the upper end of the range for the intermediate internal auditor with the lower end of the range for the senior internal auditor. However there is approximately a \$10,000 gap from the upper end of the senior internal auditor position to the low end of the range for the Director position. There is an opportunity to extend the range for the senior auditor position.

Given the pressure from the private sector with respect to the hiring of auditors to assist with the new securities requirements, the City should be proactive and look at the external market to determine if there is a gap in salary and what the countermeasures are (e.g. pension, work environment, work hours) so that the Director can be confident that the overall compensation package and job expectations are competitive and can be confident of the ability to retain staff.

Based on our review and the span of number of direct reports, we believe that the Director could have six direct reports with two being at the senior auditor level and three at the intermediate level (plus the administrative assistant). The individuals at senior auditor level should be expected to take on some managerial duties like supervising the intermediate level staff from time to time on assignments in a team leader role. Also with a team of two senior level auditors and three intermediate auditors, the staff could be teamed up on some audits in order to shorten the duration of the audits and also provide an on-site forum to deal with the more complex issues and to derive well supported conclusions. We do not see the need for a manager level position within the department.

³ Undertaken by Peel and included Region of Peel, Halton Region, City of Hamilton, City of Toronto, Brampton, Mississauga, Ottawa, York and MPAC

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Recommendations:

- Review the salary range for the Senior Internal Auditor with the intent to increase the upper end of the scale in recognition of the position being required to take on a team leader role and the supervision of staff.
- The Director should ensure she is sufficiently aware of market comparator data from the private sector to be proactive in dealing with attempts for staff to be enticed away.

In addition to membership in the Institute of Internal Auditors, the audit department has the opportunity to leverage resources of other public sector internal audit groups. These groups provide an opportunity to meet to exchange ideas and discuss issues and trends with internal auditors from other municipalities and local governments. Audit programs are discussed and exchanged by group members as well. The City's Internal Audit Department is a member of the following municipal auditing associations:

- Municipal Internal Auditors Association of Ontario (MIAA)
- Canadian Association of Local Government Auditors (CALGA)
- National Association of Local Government Auditors (NALGA)

Audit Reports and Follow Up

The Audit department issues a report to management at the conclusion of each audit. This same report is then issued to the SP&B committee. The IA department uses a standard reporting format for each report. In columnar form, the report states the observations of the Audit group (i.e. a control breakdown), recommendations from Audit on how the items could be rectified, and a space for management to record its action plan.

In interviews with the councilors common issues were noted with the reports provided by the Internal Audit group which limited the ability of the councilors to effectively understand the reports, the implications of the issues, and then provide effective oversight.

Our observation is that information is indeed lacking from the reports. However based on our review of the audit working paper files, the Internal Audit group does have the information as it has been considered in the determination of the audit plan for individual audits.

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Exhibit VIII provides an outline of standard reporting that has become common in internal audit reports to provide for more effective information sharing.

EXHIBIT VIII: ELEMENTS OF EFFECTIVE INTERNAL AUDIT REPORTS

Context for Unit being Audited – role and purpose of unit being audited including measures such as budget, volume of processing, number of staff, taxpayers/citizens impacted, funders.

Risk Profile of the Unit being Audited – an outline of the risks presented by the services and processes of the unit, such as specific operational risks, corporate risks, environmental risks, people risks, etc.

Management’s Role – a statement of management’s role in the establishment of the control environment and implementation of controls.

Internal Audit’s Role – a statement of the role that internal audit has in conducting the audit.

Scope and Objectives of the Audit – an outline of the scope of the audit, items out of scope, and the objectives of the audit.

Synthesis of Audit Findings – an overall synthesis of the nature of the findings, what the findings indicate in terms of control environment, risk management, control activities, and effectiveness of the unit.

Internal Audit’s Opinion – an opinion based on the context of the unit’s risk profile, whether controls have been adequately designed and whether controls are adequately designed, have been operated continuously and effectively. Opinions are often summarized in terms of the controls being effective, needs improvement or not effective.

Appendix of Detail – The report is supplemented with the detailed findings. Each of the detailed findings are assigned a risk indicator in terms of high, medium or low risk. This will enable the users of the report (both management and council) to know the degree of concern that they should have with respect to the issues identified.

Many internal audit functions have also developed a protocol for audit engagements and reporting. The protocol is appended to the internal audit mandate and addresses items such as:

- prior notice to the business units for upcoming audits – who is notified, the length of lead time before the audit
- communication during the audit and communicating findings – what information regarding audit observations will be provided to who and when
- addressees on audit reports – who the report will be circulated to and who is expected to respond to the report
- timelines – the number of days after completion of the field work that the draft report will be issued to management, the number of days provided to management to respond to the report

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- management response – outlining what is expected from management in response to the audit findings, i.e. what action to be taken, by who and by when
- resolution of findings – emphasizing that it is management’s responsibility to resolve the items
- opinions – the opinions to be issued by internal audit on the design of controls and operations of controls. Exhibit IX provides an example of opinions.

This protocol document is broader than the existing “Reporting Process for Internal Audit Reports” which has been put in place for the City of Hamilton.”⁴

EXHIBIT IX: TYPES OF INTERNAL AUDIT OPINIONS

Effective: Controls are designed effectively and they have generally operated as designed, and continuously during the period of review. Overall design and operation of internal controls are considered effective when the following characteristics exist:

- Policies and procedures in all critical areas are sound
- The management control environment is sound
- The design of internal controls is acceptable given risks
- The effectiveness of the internal controls is sound given risks
- Controls are sufficient to detect errors or omissions
- No material internal control deficiencies or weaknesses.

Needs Improvement: There are some key areas of control weaknesses in either design or in operation. There could be a weak design of controls, but people are compensating for the design weakness – this will generally be a short term solution and attention is needed to rectify. Alternatively, there could be an effective design, but the implementation has not been carried out effectively due to people’s diligence or lack of management control environment and supervision.

Not Effective: Controls, either the design of or operation of, are weak and require significant improvement. This would require steps to be taken quickly to improve the situation and would require senior management attention. This state would generally allow the operations of the business unit and/or the organization to be exposed to unacceptable risk.

Recommendation

- Internal Audit develop an improved reporting format considering items outlined in Exhibit VIII.
- Internal Audit to develop a reporting protocol and in it include internal audit opinions as outlined in Exhibit IX.

⁴ 2005 Internal Audit Work Plan (CM04036) report to SP&B Committee by Director Audit Services, December 17, 2004, appendix D

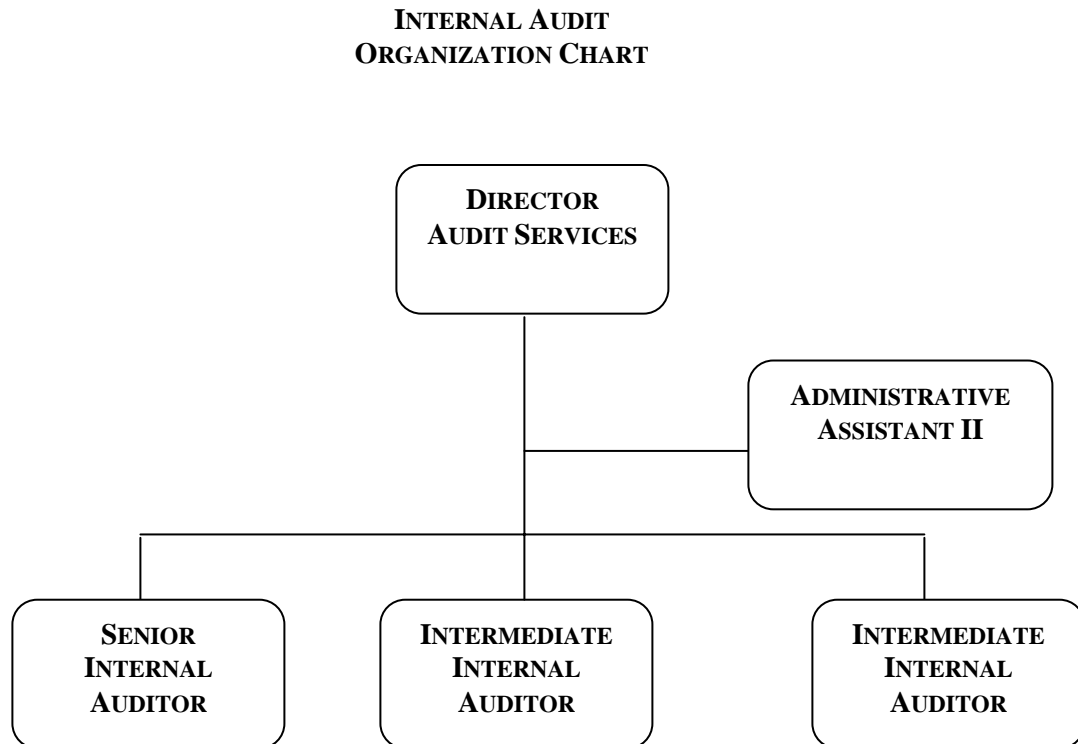
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Management of the Internal Audit Function

The current Director Audit Services has 18 years of experience in this role for the City (and predecessor Regional Municipality of Hamilton-Wentworth) and as a result is very knowledgeable of the City operations, City staff, and processes. The Director has also developed a network of other municipal auditors that she can call upon for assistance in the form of documents and guidance on particular issues and/or audits.

The four staff within the department each report to the Director Audit Services (see Exhibit X). The Director spends time with each staff member coaching them in the conduct of specific audits, setting their work schedule and deciding their training program. Through our interviews with the staff of the audit department, they are all satisfied with the reporting relationship that they have with the Director and overall the group seems to be a positive work unit.

EXHIBIT X: ORGANIZATION CHART FOR INTERNAL AUDIT DEPARTMENT



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Relationship with the External Auditors

The Internal Audit function provides a copy of each of its reports to the external auditor on request. The Internal Audit function also makes their files available to the external auditor if requested. Currently there is limited reliance on the work of the internal auditor by the external auditors.

Recommendation

- The Director Internal Audit to meet with the external auditors to understand the recent changes in the external audit approach particularly as it will include more focus on internal controls and determine if there is a means by which the external auditors can leverage work already being undertaken by the Internal Audit function. The Director can consider if it is possible to modify the audit work within reasonable effort without detracting from an operational wide focus to provide for reliance by the external auditor.

Overall Comments on the City's Existing Function

The staff in the Internal Audit function are striving to do their best for the City. They enjoy their work and are genuinely interested in providing the City departments with useful information. There are certain factors that are limiting the ability of the group to be fully effective in the role that an Internal Audit group is now expected to provide.

The governance level body to which the IA function currently reports, i.e. the Strategic Planning & Budget committee is not properly constituted to provide effective oversight on the control environment or to provide ongoing direction and leadership for the work of Internal Audit. The turnover of the SP&B committee makes it difficult to train them on the role of Internal Audit, and how to utilize the information provided by the work of the function. Aligned with this the mandate of the Audit Committee needs to be updated as does the mandate for the internal audit function although the items noted for update are in the nature of improvements on the current theme rather than wholesale changes.

While the internal audit team is qualified, it is under resourced for the breadth and complexity of the City's operations. The minimal staffing in Internal Audit and the limitations in budget and equipment makes it difficult to achieve much audit coverage and to conduct the work effectively. Financial resources are needed, equipment is needed, and the function needs to redirect regular

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recurring work back to management or else sufficiently charge for the service being provided to enable the function to bring in additional resources to focus on the internal audit work.

While an appropriate mandate is essentially in place for the internal audit function, better execution of its work would assist the City, the governing level and the senior management team.

The Director Audit Services is aware of some deficiencies in practice of the audit in relation to the performance standards as promoted by the Institute of Internal Auditors but at the same time there are other weaknesses that have not been fully identified or acknowledged by the Director. However with the limitation of resources it is difficult to put in place some of the required standards.

The number of associations that exist to encourage networking and information share across the internal audit functions of other municipalities provides resources to Hamilton's internal audit group at a nominal cost. The City's internal audit group currently participates in these and should be encouraged to continue to do so.

The City of Hamilton needs to invest in its Internal Audit function and the return will be seen in the identification of improvement to city operations (improved efficiency, decrease in costs), the prevention of fraud, and better information to Council to set the proper tone for the importance of the control environment and to provide effective oversight.

THE CITY'S NEEDS FROM THE INTERNAL AUDIT FUNCTION

The following comments are primarily derived from the interviews that were undertaken as part of this review.

Governance Requirements

We heard consistent messages from the councilors who were interviewed with respect to the work of the internal audit group. There is a common understanding that the function is necessary to provide for the appropriate checks and balances for the City as a whole. However there was a consistent frustration with the reports of the IA function. All the councilors interviewed commented that they found the internal audit reports to be difficult to understand as there was insufficient context to evaluate the importance of the items found. The councilors also found that the information tended to be dated (a significant elapsed time from when the audit was started to the time results were reported) and it was unclear what to do with the information as it appeared that management had rectified the issues found.

Recommendation

- The Internal Audit function to change its reporting format to provide the Audit Committee with a quarterly report which summarizes: changes in the City's risk profile as identified by Internal Audit, progress on the annual audit plan as approved by the Committee, summaries of the reports issued in the quarter, and a conclusion on trends that the function is observing through its work.

The councilors all stated that with the composition of the SP&B Committee and the resulting annual turnover of membership, it was difficult to get a sufficient understanding of the work of the internal audit function and the responsibility of SP&B as the Audit Committee. There was also a mixed understanding of the role of the internal audit group – some still expected the function to act as a “policing function” to catch people doing the wrong things; others are expecting the function to ensure that the city departments are complying with the procedures set out; and others are expecting the function to look for opportunities to improve operational efficiency and effectiveness.

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Recommendation

- Formally reassign the Audit Committee function responsibilities to an appropriate standing committee and provide training to the Committee on the role of internal audit and the role of the Audit Committee as outlined earlier in this report.

Senior Management Requirements

In the interviews with the general managers there was consensus that the work of the Internal Audit is very desired. All but one of the general managers would like to have additional internal audit time dedicated to their departments. They find the staff of the Internal Audit function to be helpful, conscientious and desirous of doing a good job. They also cited the need and importance for Internal Audit to be independent to enable it to conduct its work effectively.

The general managers indicated that there has been improvement in the conduct of the internal audit work and in the cooperation and respect between the departments and internal audit. Some of this has been achieved through a new reporting protocol. The draft of the internal audit report is provided to the department with the purpose of validating the information which internal audit has provided so that there should be no conflict or confusion over erroneous information when it reaches Council and councilors are trying to arrive at decisions. The new reporting structure with the Director Audit Services reporting to the City Manager has improved the communication flow without impairing the independence of the group.

The general managers saw a significant benefit of having the Internal Audit function in-house as the staff know the city, the structure, the legislation, and have networks within the City and with other city's internal audit groups.

The concerns raised by the general managers included:

- Lack of timeliness of reports from the start of the audit to when reports are received
- Advance notice for audits is not sufficient to allow their staff to make time for the audit as it does take time and adds to workload during the duration of an internal audit
- Concern that some items audited present low risk, while more time should be spent auditing high risk items

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- Recognize that Internal Audit doesn't have all specialist skills needed and they suggested that Internal Audit should be able to contract in specialist skills when needed
- Sometimes recommendations from Internal Audit were not seen as practical
- At times there is scope creep in the audit work that is not clearly understood and which places additional unplanned demands on departmental resources
- Concern with the frequency of follow-up audits since the problems that are identified have been corrected and rectified therefore it would be more helpful to audit other areas
- Much of the communication at planning stage is by email rather than face to face
- Lack of understanding and appreciation for the internal audit function throughout the City.

The general managers identified additional areas where they thought that internal audit could provide more value to the City:

- Would like to see the audit function expand to look at efficiency and effectiveness of structure and processes when in an area
- Suggested that Internal Audit take on one or two operational reviews per year
- Good advice has been provided from Internal Audit in the past, and the general managers would like to see more advice in addition to problem identification
- Would like to see the mandate of Internal Audit be expanded to include all agencies and related parties within the control of the corporation of the City of Hamilton
- Would like to see the Internal Audit department have a higher profile and be more proactive in planning and communicating activities
- Would like to see reports expanded to provide context, and opinions on ability of departments to rectify issues
- Don't want Internal Audit to move away from compliance audits
- Would like training provided to staff regarding the roles, responsibilities and terminology used in the City and its audit function.

Recommendation

- Increase communication regarding status of the audit and issues identified with the General Managers and their direct reports during audits
- Provide training to the General Managers and staff on the roles and responsibilities of internal audit as well as internal audit's methodologies, reporting protocols and opinions. We recommend

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that this training occur after Internal Audit has proceeded through its own training and visits to other municipalities and has changed its processes.

- Expand the Internal Audit mandate to include at least one operational audit per year.

Summary

The messages that we gained from the discussions from the internal stakeholders regarding the work of Internal Audit were positive in terms of the need for the function and its perspective. However improvements to the reports from Internal Audit, improvement in efficiency is the conduct of the work, and an increase in the breadth of the function's responsibilities were identified as necessary to improve the value of the function.

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BEST PRACTICES REVIEW

Learnings from Comparable Organizations

This section summarizes the findings from a series of telephone interviews held with personnel in the internal audit groups at comparable municipalities. A total of five interviews were completed with the following municipalities:

- City of Edmonton
- City of Winnipeg
- City of Ottawa
- Region of York
- City of London.

The table in exhibit XI provides a brief summary of size of the municipality and the internal audit (IA) function.

EXHIBIT XI SUMMARY OF SIZE OF MUNICIPALITIES INTERVIEWED

Characteristic	Hamilton	Edmonton	Winnipeg	Ottawa	York	London
# Staff in IA	5	15	10	8	4+	6
IA Consulting Budget	\$0	\$85 K	\$50 K	\$500 K	\$75 K	\$0
Total IA Budget	\$500 K	\$1.7 M	\$1.0 M	\$1.4 M	\$300 K	\$n/a
# City/Region Staff	6,200	9,800	8,800	12,000	3,500	2,300
Annual City/Region Budget	\$1.0 B	\$1.5 B	\$1.0 B	\$2.0 B	\$1.5 B	\$800 M

K= thousands; M = millions; B = billions; n/a = not available

+ The Region of York fulfills its responsibilities for audits of new projects by contracting external resources that are funded by the project budgets, rather than the Internal Audit budget.

The internal audit function for the City of Edmonton underwent an operational review in 2000. Since 2002, the cities of Toronto, Ottawa and Calgary also reviewed their internal audit functions. Following the results both Toronto and Ottawa adopted an Auditor General model. Calgary, which was last to conduct its review, maintained an internal audit function.

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Organizational Structure and Mandate

The City Auditor By-law for the City of **Edmonton** from November 2002 outlines the relationships and mandate for the City Auditor as follows:

- The City Auditor is appointed by and reports to council and the Audit Committee.
- Although the City Auditor is independent of the City Manager, the City Manager is responsible for providing administrative support.
- The mandate includes two roles as well as additional responsibilities:
 1. Agent of Change – Providing strategic, risk and control-related consulting services to serve the changing needs of the corporation and improve program performance.
 2. Guardian – Providing assurance through review of existing operations, effectiveness, economy, and controls.
 3. Investigations regarding matters brought to the Auditor’s attention by third parties.
 4. Special projects – As instructed by council.
- The City Auditor is responsible for internal auditing activities related to the City’s programs and agencies.
- The City Auditor is not responsible for external audit activities. However, with the External Auditor, ensures efforts are not duplicated.

The legislative mandate for the City Auditor for **Winnipeg**, set out in Sections 102-107 of the City of Winnipeg Charter, provides the following:

- The City Auditor reports directly to council through the Audit Committee.
- The City Auditor is independent of the City Manager.
- The main areas addressed in the mandate are summarized as follows:
 1. Financial and operational internal control systems, including business risks.
 2. Compliance with legislation
 3. Operations and Programs – Economy, efficiency and effectiveness
 4. Consulting activities.
 5. Investigations regarding matters brought to the Auditor’s attention by third parties.
 6. Matters directed by council.
- City Auditor is responsible for internal auditing activities related to the City and affiliated bodies.
- The City Auditor is not responsible for external audit activities.

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The Auditor General for the City of **Ottawa** was appointed in September 2004, following the restructuring of the City's Audit & Consulting Services function. Greater emphasis is now placed on performance audits of operational areas of the City.

- The Auditor General reports directly to council through the Corporate Services & Economic Development Committee.
- The Auditor General is independent of the City's Administration. Financial independence is achieved because the Auditor's budget is established as a fixed percentage of the City's total operating budget.
- The objective of the Auditor General is to provide stewardship of public funds. The services provided to address this objective include:
 1. Financial audits, excluding the external attest audit.
 2. Performance audits, that is, value-for-money audits.
 3. Compliance audits, which address adherence to policies, procedures, and regulations.
- The Auditor General is responsible for audit activities related to City departments, boards, and affiliated bodies.
- The Auditor General is not responsible for external audit activities.

The internal audit function for the Region of **York** was established approximately four years ago, following an external assessment completed in Fall 2004. The Audit Services Department is headed by the Director of Audit Services.

- The Director reports functionally to the Audit Committee and administratively to the region's Chief Administrative Officer.
- The mandate of the department is defined in Report No. 4 of the Regional Audit Committee Meeting held on October 11, 2000 as follows:
 1. Assist council and employees of the Region in the effective and efficient discharge of their responsibilities.
 2. Providing objective advice on managing and controlling risk
 3. Independent appraisals on control.
 4. Providing advice regarding the identification of efficiencies and improvements in new and existing processes, programs and services.
- All entities and activities of the Region, except Police Services, fall within the mandate of the function.
- The Department is not responsible for external audit activities.

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The City of **London**'s internal audit group is part of a larger department that is responsible for Management Support, Audit and Risk. The reporting relationships of the function have changed within the last year and now provide greater focus on audit services.

- The Director of Management Support, Audit and Risk reports functionally to the City's Chief Administrative Officer. The Senior Manager of Audit and Management Support Services reports to the Director. Within the last year, a functional reporting relationship with the Audit Committee was established.
- The internal audit department provides two main types of services:
 1. Audit of systems implementation and compliance.
 2. Management support and consulting.
- All entities and activities of the City fall within the scope of the Internal Audit function.
- The Department is not responsible for external audit activities.

All interviewees stated that the internal audit department requires an effective delegation of authority from the governing level. Six conditions were identified as important to provide for the necessary independence for internal audit:

- A clear statement of responsibilities
- A clear understanding of the authority of the function
- A clear understanding of the scope of the function
- Availability of information/personnel and access to that information/personnel
- A clear statement of the reporting lines for the function
- Adequate resources and expertise to perform the necessary work.

Scope, Assignments and Reports

The City of **Edmonton**, bylaw 12424, City Auditor bylaw (consolidated on November 26, 2002) states that "*The City Auditor will have two roles:*

- (a) *Agent of Change Role – proactive and forward-looking projects focused on provision of strategic, risk and control-related consulting services to better serve the changing needs of the corporation and help bring about improvement in program performance; and*
- (b) *Guardian Role – projects directed primarily towards providing assurance through review of existing operations, effectiveness, economy, and controls.*"

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In its 2005 Annual Work Plan, the Edmonton City Auditor added Comprehensive Audits to the work plan. By way of allocation of time, the projects for the 2005 year were identified as follows:

Project Type	Number of Audits
Guardian	12
Agent of Change	6
Guardian/Agent of Change	3
Comprehensive Audit projects	3
Total	24

In percentage terms, 50% is allocated to Guardian type audits; 25% to Agent of Change; 12.5% to a combination of Guardian/Agent of Change; and 12.5% to Comprehensive Audits. The vast majority of the department's time is on the guardian and agent of change duties.

The City Auditor for the City of **Winnipeg** stated in her 2003 Report on Performance that “*we balance our role as legislative auditors with our role as internal consultants to management.*” The report lists that the department performs:

- Assurance projects defined as independent professional services that improve the quality of information or its context for decision makers; includes performance audits, compliance audits, due diligence reviews, control and risk self-assessments.
- Investigation services
- Advisory and consulting services.

Since 2003, the time spent on advisory and consulting services has declined significantly due to the increased focus on controls and compliance following the introduction of Sarbanes-Oxley.

The City of **Ottawa** performs audits of compliance with rules and regulations and this represents approximately 30% of the department's time. Approximately 40% of the time is used for performance audits, which are concerned with value-for-money and whether the City is meeting its objectives economically. The remaining 30% is used to perform financial control and general audits. One or more of these types of audits may be addressed in one audit assignment.

The 2005 to 2007 audit plan provides for approximately 10 major audits per year, in addition to a contingency for unplanned items and council requests. The plan does not provide for regular, recurring work done on behalf of city departments.

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The Region of **York**'s Internal Audit department utilizes approximately 60% to 70% of its time on operational and compliance audits of controls; approximately 10% for information technology project specific audits; 20% for consulting, and 5% to 10% for forensic investigations and special assignments. Additional funding for audit functions comes from two major sources:

- New projects must include a budget for audit services. These services are overseen by the Region's in-house Internal Audit Department, but the services are provided by external resources, selected from a pre-approved vendor list and paid for through the project budget.
- Police Services has 2 auditors who are responsible for audits of the police department.

The Internal Audit function in **London** has focused primarily on management support services in the past. However, there has been a recent change in focus and approximately 50% of the department's time will be spent on system implementation and compliance audits, with the remaining time devoted to consulting.

The Director Audit Services for the City of Hamilton in the December 17, 2004 report to the SP&B Committee provided an outline of three types of audits (definition in exhibit XII):

- Internal Control/Compliance Audits
- Operational/Value for Money Audits
- Special Reviews/Investigations

These three categories are appropriate for the City of Hamilton. It should be noted that in addition to the above, the City's Internal Audit group performs regular, recurring audit work for some City departments. While this work is of value to the City, it diverts audit resources to the efforts of other departments.

EXHIBIT XII TYPES OF AUDITS

Internal Control/Compliance audits

- Identification and documentation of systems of internal financial and operational controls
- Assessment of whether the internal control structure (financial, management and systems) is suitably designed and implemented to safeguard assets
- Determination whether organizational units are performing planning, accounting, custodial and control activities in compliance with relevant legislation, contractual obligations, program requirements and Council/management directions
- For instance:
 - Controls over computerized systems
 - Accuracy of data and improved management information
 - Review of transactions for proper support
 - Better design of a system or process
 - Balance of risk and cost/value of particular controls

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Operational/Value for Money Audits

- Examination of the purpose of providing an assessment of the performance of a department, program or activity
- Determination of whether an entity is managing or utilizing its resources (personnel, equipment, property) in an effective, economical and efficient manner
- In this broader application, improvements are more likely to be of greater value
- For instance:
 - Costs and benefits of maintaining a current operations under the existing policies and procedures
 - Any improvements possible as a result of different policies or procedures
 - Improved customer service
 - Potential new sources of revenue
 - Causes of inefficiencies or uneconomical practices
 - Extent to which desired results or benefits are being achieved
 - Review expenditures to determine whether the service was necessary and could be obtained at a lesser cost (potential cost savings)

Special Reviews/Investigations

- Very focused reviews, usually of one special area
- Vary widely in subject, depending on particular circumstances
- For instance:
 - Investigations in which allegations of fraud have been made
 - Investigations of details of a very specific incident/event

In the creation of the City of Hamilton's annual internal audit work plan, the Director identified 15 audits: with 3 identified as carry over from 2004 (fit the internal control definitions); 6 are classified as annual but not classified as to type; and 6 are classified as internal control / compliance / financial audit. While there were assignments identified as potential operational / value for money audits none were selected for 2005 until there is agreement on whether the Internal Audit department should in fact be carrying out this type of work.

Recommendation

- The City of Hamilton internal audit department undertake one operational audit per year. Selection of the individual area for the audit should be supported by rationale in terms of potential benefit.
- Transfer some of the regular recurring work back to management (e.g. revenues at Police Services).

The **Edmonton** City Auditor provides the following reports to its Audit Committee:

- A long-term audit plan that is aligned with the City's business objectives and an enterprise-wide risk management methodology.

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- An annual work plan – this summarizes how audits were selected and what audits will be completed in the current year.
- Quarterly reports summarizing activities during the quarter including a high level summary of findings from each audit; audits in progress; status of progress on the annual plan; a summary of the budget to actual status; and other significant items (if any).
- An annual report which summarizes the issues and observations noted during the fiscal year; the audit projects completed; corporate involvement; and the performance of the internal audit function including reporting against benchmarks.

Winnipeg's Internal Auditor provides:

- A report which outlines the planning process for the year in developing the annual audit plan and a longer term audit plan.
- A report for each audit completed that contains an executive summary, background of the unit, objectives of the audit, scope and approach of the audit, a risk assessment of the unit, overall conclusions; and then the detailed findings in an appendix.
- An annual report that summarizes the Performance of the department including a summary of audits completed and measurement of the function's performance against benchmarks.

Since the City of **Ottawa** created the Office of the Auditor General in 2004, the following documents and reports have been presented:

- By-law to establish the position and duties of the Auditor General
- Summary presentation of statute and mandate
- The 2005-2007 Audit Plan

The first Annual Report will be issued in 2006 and will report on the 2005 audit activity.

The Audit Committee for the Region of **York** reviews the three-year internal audit plan annually. The Audit Committee charter requires a minimum of 2 meetings per year, but 3 meetings has been recent practice. Audit reports are presented at these meetings.

Based on what we have seen from the other municipalities we reaffirm our recommendations earlier that the Hamilton Auditor develop a more informative reporting format for individual audits and provide robust quarterly reports to the Audit Committee.

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Through our interviews and review of documents from the internal audit department of these other municipalities we were impressed by the work being done by those groups.

Recommendation

- The Hamilton internal auditors each take two days to spend time learning on site from other public sector internal audit groups. We recommend that the Director visit the City of Edmonton IA group; the Senior Internal Auditor - City of Winnipeg, an intermediate auditor - Region of York, and an intermediate auditor - City of London. This can be counted towards the annual training targets for the members of the audit department. During these on site learning visits, the Hamilton staff should specifically focus on gaining knowledge on how to develop the audit universe and the annual internal audit plan, how to execute an individual audit, and how to report out on the results of internal audits to both senior management and the governance level. After the field visits the staff to convene to share the learnings in a session facilitated by an outside facilitator, and identify application of the learnings to the City of Hamilton audit work and action plans on implementing. We are specific on naming the municipalities to be visited and by what level of staff in order to ensure that the appropriate best practices are being sought out.

Resources

Exhibit XIII presents a summary of comparative data for the municipalities and presents benchmarks.

EXHIBIT XIII COMPARATOR BENCHMARKS

Current Status						
Characteristic	Hamilton	Edmonton	Winnipeg	Ottawa	York ⁵	London
IA Professional Staff	4	14	9	7	3+	5
IA Administrative Staff	1	1	1	1	1	1
Total IA Staff	5	15	10	8	4	6
IA Consulting Budget	\$0	\$85 K	\$50 K	\$500 K	\$75 K	\$0
IA Total Budget	\$500 K	\$1.7 M	\$1 M	\$1.4 M	\$300 K	n/a
Annual City Budget	\$1 B	\$1.5 B	\$1 B	\$2 B	\$1.5 B	\$800 M
# of City Staff	6,200	9,800	8,800	12,000	3,500	2,300
# of Citizens ⁶	490,000	666,000	620,000	774,000	772,000	337,000

⁵ Region of York fulfills its responsibilities for audits of new projects by contracting external resources that are funded by the project budget, rather than through the budget of the Internal Audit department.

⁶ Taken from the 2001 census

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Internal Audit Coverage Ratios						
# of City Staff / IA Staff	1,240	650	880	1,500	875	385
# of Citizens / IA Staff	98,000	44,400	62,000	96,700	193,000	56,000
Annual City Budget/IA Staff	\$200 M	\$100 M	\$100 M	\$250 M	\$375 M	\$135 M
IA Budget/Annual City Budget	0.050%	0.113%	0.100%	0.070%	0.020%	n/a

If the staffing for the City of Hamilton internal audit staff is increased by 2 persons, a salary range review is provided, and a \$200,000 consulting budget is provided the statistics would be approximately the following:

Characteristic	Current	Recommended
IA Professional Staff	4	6
IA Administrative Staff	1	1
Total IA Staff	5	7
IA Consulting Budget	\$ 0	\$200 K
IA Total Budget	\$500 K	\$850 K
Annual City Budget	\$1 B	\$1 B
# of City Staff	6,200	6,200
# of Citizens	490,000	490,000
Internal Audit Coverage Ratios		
# of City Staff / IA Staff	1,240	885
# of Citizens / IA Staff	98,000	70,000
Annual City Budget / IA Staff	\$200 M	\$145 M
IA Budget / Annual City Budget	0.050%	0.085%

All of the comparator organizations surveyed had highly qualified staff, most of whom had one or more professional designations. In addition, most of the comparators used consulting resources to hire specialized skills, such as information technology, engineering, health care, etc. The exception to this is the City of Edmonton. Although Edmonton has a consulting budget it has not been used in the last two years because the specialized skills needed were possessed by the internal audit staff members. Unlike other internal audit departments, including Hamilton's, the City of Edmonton's auditors includes 4 engineers, 1 social worker, 1 psychologist and 3 MBAs in addition to CAs, CMAs, CIAs, CFEs, and CCSAs. However, Edmonton has used their consulting budget in the past when audit needs did demand additional specialized skills.

The majority of the municipalities surveyed were concerned that the consulting budgets were too low to meet their mandates. To obtain a consulting budget, the Auditor General for Ottawa reorganized the department to free up budget funds.

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Recommendation

- Based on the size of the City of Hamilton, the comparables and the work that the Hamilton Internal Audit function should be conducting, we recommend increasing the staff complement by 2 full time positions at the senior auditor level (or possibly one at senior auditor level and one at intermediate auditor level) and a consulting budget of \$200,000 be incorporated into the internal audit department's budget for the Director to use in engaging specialized skills.

All internal audit departments have training and professional development programs with one to two weeks per staff member devoted annually to professional development activities. Particularly during transition phases, two weeks annually of professional development time is desirable.

The Professional Standards for Internal Audit

The standards developed by the Institute of Internal Auditors (IIA) for the Professional Practice of Internal Auditing, were cited by all the internal audit groups surveyed. These standards encompass independence, professional proficiency, scope of work, performance of audit work and management of internal audit groups.

In 2004, the IIA revised its standards for the conduct of Internal Auditing and categorized requirements in two streams: Attribute Standards; Performance Standards. The standards address the following areas:

Attribute Standards

- Purposes, Authority, and Responsibility of the internal audit function (section 1000);
- Independence and objectivity of the internal audit function (section 1100)
- Proficiency and due professional care of internal auditors (section 1200);
- Quality assurance and improvement program (section 1300)

Performance Standards

- Managing the internal audit activity (section 2000);
- Nature of the work (section 2100)
- Engagement planning (section 2200)
- Performing the engagement (section 2300)

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- Communicating results (section 2400)
- Monitoring progress (section 2500)
- Resolution of management's acceptance of risks (section 2600).

All of the comparator municipalities incorporated the IIA standards into their own internal policies and procedures.

A brief overview of how the City's internal audit group performs relative to the IIA standards is presented in appendix A.

Recommendation

- The Hamilton Internal Audit department perform a detailed self-assessment of its practices against the IIA standards every three years (to stay aligned with evolving practices).
- The Hamilton department develop a manual for the Internal Audit function that incorporates the mandate, audit approach, protocols, as well as policies (e.g. refraining from auditing where personnel previously had responsibility, access to files).
- Internal Audit to develop a program of quality assurance reviews of its own work.
- Include in the Internal Audit mandate that every three years Internal Audit is to survey its stakeholders (i.e. Audit Committee and City Management Team) on satisfaction of the work and performance of the internal audit department.
- The Hamilton Internal Audit function arrange for a quality assurance review by an outside accredited firm or by the Institute of Internal Auditors every five years.

Summary

There are excellent practices in place at the municipalities that we interviewed and it would be advantageous for the City of Hamilton staff to visit and learn first hand what the techniques are that these groups have in place.

**The City of Hamilton
External Review of the Internal Audit Division
Findings and Conclusions**

FINDINGS AND CONCLUSIONS

The primary purpose of the operational review of the City of Hamilton Internal Audit function was to recommend opportunities for improvement based on best practices in public internal audit operations and to capture the roles that the function could provide and the resources required to perform them.

A well functioning Internal Audit function is an invaluable resource to all organizations but particularly so in the public sector given the extensive accountability. The Internal Audit function can assist the governance level in the performance of their oversight duties by providing the right information focused on the areas of highest risk for the City. The function can also assist in providing for a strong control environment by keeping a focus on the need for the right controls to be in place to provide for safeguarding of assets, compliance with laws and regulations, integrity of information, as well as the efficiency and effectiveness of operations.

The City of Hamilton has demonstrated its appreciation for the value of internal audit by having the function in place and by contracting for this operational review. The review has identified that the current staff are working diligently but the group needs additional resources to adequately address the breadth and complexity of the City operations and attention is needed to improve how the staff execute audit activities to fulfill the Internal Audit mandate.

The mandate of the IA department is appropriate, however it needs to be updated to reflect the current situation, as well as changes resulting from this review. The professional standards followed are also appropriate.

Reporting to council is essential, and the recently established functional reporting line to council through a committee is a positive first step. However, we see a need for a stronger and more formal relationship and suggest that oversight and governance responsibility for audit be reassigned to a more appropriate standing committee. Top down support for the internal auditor is essential for the department to operate effectively.

A solid relationship with City staff is also necessary in carrying out audit duties. Currently, the City Management Team is pleased with the work done by Internal Audit and has an appetite for

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increased emphasis on operational and value-for-money audits. The City Management Team supports the need for an independent and unrestricted internal audit department.

The scope of the Internal Audit function needs to be clearly defined and communicated amongst council, the Internal Audit department, and the City Management Team. Formal risk-based audit plans should be approved and monitored by council. Most of the comparator municipalities have adopted this approach and it is consistent with professional standards.

The Internal Audit department provides detailed reports, which are appreciated by staff. However, the reports are inadequate in helping council assess risk and discharge governance responsibilities. Therefore, we see a need for improvement in the reports provided by the function.

The City's Internal Audit staff are well qualified, with many years of experience. The function is, however, under-resourced when compared to peer municipalities and this restricts the ability to deliver on the mandate. We see a need for increases in both the number of staff in the department and in the budget to be able to engage specialized technical skills on a contractual basis. Additionally there is a need for specific equipment to be provided to the audit personnel to improve their efficiency (i.e. lap top computers).

Initial and on-going training and development is necessary, not only for audit staff members, but for council and the City Management Team. Awareness training for council and management will be the first step that the City needs to take in this regard. We see a need for training for the Internal Audit function on risk based audit methodology and reports. We were impressed by the comparator municipalities and recommend an Internal Audit staff training program incorporate visits to these organizations.

Refer to appendix B for the complete list of recommendations provided. Having met with a number of councilors during this review, the City Management Team and the Internal Audit staff, we believe that there is a willingness to improve on the internal audit and audit committee mandates in order to better serve the City and its stakeholders.

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Appendix A: Comparison Against IIA Standards

APPENDIX A: COMPARISON AGAINST IIA STANDARDS

Following is a high level summary of the practices of the Internal Audit Function for the City of Hamilton's compared to the standards as set by the Institute of Internal Auditors.⁷

Recommendations have been made throughout this report that will have an impact on the City's practices if implemented. In these cases, *Recommendation* has been noted.

ATTRIBUTE STANDARDS	
Standard	City of Hamilton
1000 – Purpose, Authority, and Responsibility The purpose, authority, and responsibility of the internal audit activity should be formally defined in a charter, consistent with the Standards, and approved by the Board.	Requirement met in current mandate.
1000.A1 - The nature of assurance services provided to the organization should be defined in the audit charter. If assurances are to be provided to parties outside the organization, the nature of these assurances should also be defined in the charter.	Touched on in responsibilities but could be more explicit. <i>Recommendation.</i>
1000.C1 - The nature of consulting services should be defined in the audit charter.	Not explicitly covered in mandate. <i>Recommendation.</i>
1100 – Independence and Objectivity The internal audit activity should be independent, and internal auditors should be objective in performing their work.	Audit charter identifies need for independence. There are terms of reference from 2002 for the Audit Sub-Committee. In that document the Director of Audit Services is provided with direct and open communication with the committee.
1110 – Organizational Independence The chief audit executive should report to a level within the organization that allows the internal audit activity to fulfill its responsibilities.	The Director reports administratively to the City Manager and functionally to council through SP&B. Access to Council and organizational support for the function could be improved. <i>Recommendation.</i>
1110.A1 - The internal audit activity should be free from interference in determining the scope of internal auditing, performing work, and communicating results.	The authority within the mandate states that Internal Audit has unrestricted access to people and information. Scope could be clarified. <i>Recommendation.</i>
1120 – Individual Objectivity Internal auditors should have an impartial, unbiased attitude and avoid conflicts of interest.	There is no audit manual, or documented policy on conflict of interest. The staff do abide by the City's general requirements.

⁷ Effective January 2004

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ATTRIBUTE STANDARDS	
Standard	City of Hamilton
<p>1130 – Impairments to Independence or Objectivity If independence or objectivity is impaired in fact or appearance, the details of the impairment should be disclosed to appropriate parties. Nature of disclosure will depend upon the impairment.</p>	<p>The terms of reference for the Audit Sub-Committee provides that the committee will ensure that internal auditors are not restricted or impeded in the conduct of work. The Director should report on this quarterly. <i>Recommendation.</i></p>
<p>1130.A1 – Internal auditors should refrain from assessing specific operations for which they were previously responsible. Objectivity is presumed to be impaired if an internal auditor provides assurance services for an activity for which the internal auditor had responsibility within the previous year.</p>	<p>There is no audit manual or documented policy to cover this. However, only one of the current staff members has worked elsewhere in the City in the previous year. <i>Recommendation.</i></p>
<p>1130.A2 – Assurance engagements for functions over which the chief audit executive has responsibility should be overseen by a party outside the internal audit activity.</p>	<p>The Director Internal Audit does not have responsibility for any other function so this is not an issue. However, the position description needs to be updated with respect to general duties. <i>Recommendation.</i></p>
<p>1130.C1 – Internal auditors may provide consulting services relating to operations for which they had previous responsibilities.</p>	<p>There is no audit manual or documented policy to cover this. <i>Recommendation</i></p>
<p>1130.C2 – If internal auditors have potential impairments to independence or objectivity relating to proposed consulting services, disclosure should be made to the engagement client prior to accepting the engagement.</p>	<p>There is no audit manual or documented policy to cover this. <i>Recommendation</i></p>
<p>1200 – Proficiency and Due Professional Care Engagements should be performed with proficiency and due professional care.</p>	<p>Position descriptions exist for all levels in the function. Current staff have good credentials. All work is subject to review by the Director.</p>
<p>1210 – Proficiency Internal auditors should possess the knowledge, skills, and other competencies needed to perform their individual responsibilities. The internal audit activity collectively should possess or obtain the knowledge, skills, and other competencies needed to perform its responsibilities.</p>	<p>Function only takes on assignments for which they have competency. Director of function has many years of experience in municipality.</p>
<p>1210.A1 – The chief audit executive should obtain competent advice and assistance if the internal audit staff lacks knowledge, skills, or other competencies needed to perform all or part of the engagement.</p>	<p>The Director is very experienced and shares that knowledge with the staff.</p>
<p>1210.A2 – Internal auditor should have sufficient knowledge to identify indicators of fraud but is not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud.</p>	<p>One staff member is a Certified Fraud Examiner.</p>

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ATTRIBUTE STANDARDS	
Standard	City of Hamilton
<p>1210.A3 – Internal auditors should have knowledge of key information technology risks and controls and available technology-based audit techniques to perform their assigned work. However, not all internal auditors are expected to have the expertise of an internal auditor whose primary responsibility is information technology auditing.</p>	<p>Not a lot of audit work has been performed in the information technology area. Staff members have recently begun to use Active Data, an excel program add-on, to extract data for audits being conducted. A budget is needed to hire skills in this area. <i>Recommendation.</i></p>
<p>1210.C1 - The chief audit executive should decline the consulting engagement or obtain competent advice and assistance if the internal audit staff lacks the knowledge, skills, or other competencies needed to perform all or part of the engagement.</p>	<p>The function does not take on assignments for which they do not have competency. However with limited funds, this may mean that certain assignments are overlooked. A budget is needed for engaging specialist resources. <i>Recommendation.</i></p>
<p>1220 - Due Professional Care Internal auditors should apply the care and skill expected of a reasonably prudent and competent internal auditor. Due professional care does not imply infallibility.</p>	<p>Work performed identifies business unit goals and objectives, business processes, related risks and controls, and the nature, extent and timing of audit work to be performed. Director reviews all audit work.</p>
<p>1220.A1 - The internal auditor should exercise due professional care by considering the:</p> <ul style="list-style-type: none"> • Extent of work needed to achieve the engagement's objectives. • Relative complexity, materiality, or significance of matters to which assurance procedures are applied. • Adequacy and effectiveness of risk management, control, governance processes. • Probability of significant errors, irregularities, or non-compliance. • Cost of assurance in relation to potential benefits. 	<p>During planning stage each year, the Director considers various factors that would identify where audit focus is necessary. Each auditor is required to conduct planning and prepare planning memo and have it reviewed by the Director before commencing the work. No documented audit manual or audit methodology. <i>Recommendation.</i></p>
<p>1220.A2 - In exercising due professional care the internal auditor should consider the use of computer-assisted audit tools and other data analysis techniques.</p>	<p>Function uses Active Data to perform data extractions, as well as standard and customized reports generated from the City's information systems.</p>
<p>1220.A3 – The internal auditor should be alert to the significant risks that might affect objectives, operations, or resources. However, assurance procedures alone, even when performed with due professional care, do not guarantee that all significant risks will be identified</p>	<p>The staff identify risks during the planning work and in developing audit procedures. In files, there is an assessment of risks of findings but does not get focus in the end report. <i>Recommendation.</i></p>
<p>1220.C1 - The internal auditor should exercise due professional care during a consulting engagement by considering the:</p> <ul style="list-style-type: none"> • Needs and expectations of clients, including the nature, timing, and communication of 	<p>Unable to determine without departmental manual covering how these types of engagements would be handled. <i>Recommendation.</i></p>

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ATTRIBUTE STANDARDS	
Standard	City of Hamilton
<p>engagement results.</p> <ul style="list-style-type: none"> • Relative complexity and extent of work needed to achieve engagement’s objectives. • Cost of consulting engagement in relation to potential benefits. 	
<p>1230 – Continuing Professional Development Internal auditors should enhance their knowledge, skills, and other competencies through continuing professional development.</p>	<p>Staff attend courses and seminars to continue to enhance their abilities and maintain their professional certifications. Generally each staff member in the department gets one week per year of ongoing professional development.</p>
<p>1300 – Quality Assurance and Improvement Program Chief audit executive should develop and maintain quality assurance and improvement program that covers all aspects of internal audit activity and continuously monitors its effectiveness. This program to include periodic internal and external quality assessments and ongoing internal monitoring. Each part of the program should be designed to help the internal auditing activity add value and improve the organization’s operations and to provide assurance that internal audit activity is in conformity with Standards and Code of Ethics.</p>	<p>The department sends out a client satisfaction questionnaire at the end of each audit. No evidence of an internal survey to stakeholders as a whole conducted by the Function. No external review until now. <i>Recommendation</i></p>
<p>1310 – Quality Program Assessments The internal audit activity should adopt a process to monitor and assess the overall effectiveness of the quality program. The process should include both internal and external assessments.</p>	<p>Function has no quality program. <i>Recommendation</i></p>
<p>1311 – Internal Assessments Internal assessments should include: Ongoing reviews of the performance of the internal audit activity; and Periodic reviews performed through self-assessment or by other persons within the organization, with knowledge of internal audit practices and the Standards.</p>	<p>No internal assessment process in place. <i>Recommendation.</i></p>
<p>1312 – External Assessments External assessments, such as quality assurance reviews, should be conducted at least once every five years by a qualified, independent reviewer or review team from outside the organization.</p>	<p>No expectation set for the function. <i>Recommendation.</i></p>
<p>1320 – Reporting on the Quality Program The chief audit executive (CAE) should communicate the results of external assessments to the board.</p>	<p>Strategic Planning & Budget committee has requested this current assessment so they will receive this. However going forward this should be covered in the function’s mandate. <i>Recommendation.</i></p>

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ATTRIBUTE STANDARDS	
Standard	City of Hamilton
<p>1330 – Use of "Conducted in Accordance with the Standards" Internal auditors are encouraged to report that their activities are "conducted in accordance with the International Standards for the Professional Practice of Internal Auditing." However, internal auditors may use the statement only if assessments of the quality improvement program demonstrate that the internal audit activity is in compliance with the Standards.</p>	<p>Not currently done <i>Recommendation</i></p>
<p>1340 – Disclosure of Non-compliance Although the internal audit activity should achieve full compliance with the Standards and internal auditors with the Code of Ethics, there may be instances in which full compliance is not achieved. When non-compliance impacts the overall scope or operation of the internal audit activity, disclosure should be made to senior management and the board.</p>	<p>No instances identified. Policies and procedures to address this scenario do not exist <i>Recommendation</i></p>

PERFORMANCE STANDARDS	
Standard	City of Hamilton
<p>2000 – Managing the Internal Audit Activity The CAE should effectively manage the internal audit activity to ensure it adds value to the organization.</p>	<p>Audit plan drafted annually tries to incorporate areas of attention as identified by the general managers and councilors. <i>Recommendation.</i></p>
<p>2010 – Planning The CAE should establish risk-based plans to determine the priorities of the internal audit activity, consistent with the organization's goals.</p>	<p>Risk is stated as being part of the decision process in deciding what needs to be audited. <i>Recommendation</i></p>
<p>2010.A1 - The internal audit activity's plan of engagements should be based on a risk assessment, undertaken at least annually. The input of senior management and the Board should be considered in this process.</p>	<p>At planning stage of annual internal audit plan, general managers are consulted to identify risk areas or areas of focus for Internal Audit. Same for councilors. <i>Recommendation.</i></p>
<p>2010.C1 - CAE should consider accepting proposed consulting engagements based on the engagement's potential to improve management of risks, add value, and improve the organization's operations. Those engagements accepted should be included in the plan.</p>	<p>No policies or procedures exist to address this issue. <i>Recommendation</i></p>

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PERFORMANCE STANDARDS	
Standard	City of Hamilton
<p>2020 – Communication and Approval The CAE should communicate the internal audit activity’s plans and resource requirements, including significant interim changes, to senior management and to the board for review and approval. The CAE should also communicate the impact of resource limitations.</p>	<p>The Director presents the annual plan at the beginning of the year, and assignments decided on are within competencies and within resources available. Improved communication with senior management and with council is needed. <i>Recommendation.</i></p>
<p>2030 – Resource Management The chief audit executive (CAE) should ensure that internal audit resources are appropriate, sufficient, and effectively deployed to achieve the approved plan.</p>	<p>List of staff experience, education and training is maintained. Assignments are typically based on staff experience. A written job description exists for each position, with accompanying set of core competencies required – ensures staff have the skill set to carry out their duties</p>
<p>2040 – Policies and Procedures The CAE should establish policies and procedures to guide the internal audit activity.</p>	<p>Given small size of internal audit group, formal documented policies and procedures do not exist. There is a need to develop policies and procedures. <i>Recommendation</i></p>
<p>2050 – Coordination The CAE should share information and coordinate activities with other internal and external providers of relevant assurance and consulting services to ensure proper coverage and minimize duplication of efforts.</p>	<p>Audit reports are provided to the external auditors, however, a confidentiality clause is not included, although external auditors have an obligation to keep information confidential. Policies and procedures do not exist to address the coordination of sharing information.</p>
<p>2060 – Reporting to the Board and Senior Management The CAE should report periodically to Board and senior management on internal audit activity’s purpose, authority, responsibility, and performance relative to its plan. Reporting should also include significant risk exposures and control issues, corporate governance issues, and other matters needed or requested by Board and senior management.</p>	<p>Director reports to Strategic Planning & Budget whenever there is a report that has been issued since prior meeting. Audit reports are prepared for each engagement and delivered to business unit heads. Reporting against plan could be provided on a regular recurring basis throughout the year to both SP&B and CMT. Mandate for department has not been updated for a few years. <i>Recommendation.</i></p>
<p>2100 – Nature of Work The internal audit activity should evaluate and contribute to the improvement of risk management, control, and governance processes using a systematic and disciplined approach.</p>	<p>Risk based approach said to be used to develop annual audit plan. Planning for each engagement considers risks facing the business unit. Reporting could provide better outline of risk. <i>Recommendation.</i></p>
<p>2110 – Risk Management Internal audit activity should assist the organization by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and control systems.</p>	<p>While risk is considered by internal auditors during conduct of work, there could be better reporting annually and within each individual report on what the risks actually are and how they are being managed. <i>Recommendation.</i></p>

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PERFORMANCE STANDARDS	
Standard	City of Hamilton
2110.A1 – The internal audit activity should monitor and evaluate the effectiveness of the organization’s risk management system.	The City does not have a formal risk management system, however audits consider the risks of business unit and mitigating controls. Each audit considers compliance with policies and procedures (P&P is control framework for the City).
2110.A2 - The internal audit activity should evaluate risk exposures relating to the organization's governance, operations, and information systems regarding the <ul style="list-style-type: none"> • Reliability and integrity of financial and operational information. • Effectiveness and efficiency of operations. • Safeguarding of assets. • Compliance with laws, regulations, contracts 	Risk is considered in execution of the work. Focus on risk is minimal in the mandate for the internal audit function. <i>Recommendation</i>
2110.C1 - During consulting engagements, internal auditors should address risk consistent with the engagement’s objectives and be alert to the existence of other significant risks.	No policy to cover this. <i>Recommendation.</i>
2110.C2 – Internal auditors should incorporate knowledge of risks gained from consulting engagements into the process of identifying and evaluating significant risk exposures of the organization.	Planning for audit engagements includes business profiling and identification of risks. Risks identified in consulting engagements would be included in the list of risks for the audit engagement
2120 – Control The internal audit activity should assist the organization in maintaining effective controls by evaluating their effectiveness and efficiency and by promoting continuous improvement.	Reports for each audit engagement identify weaknesses and opportunities to improve controls. No overall evaluation or opinion is provided on whether controls within the unit being audited are effective or not. <i>Recommendation.</i>
2120.A1 - Based on the results of the risk assessment, the internal audit activity should evaluate the adequacy and effectiveness of controls encompassing the organization's governance, operations, and information systems. This should include: <ul style="list-style-type: none"> • Reliability and integrity of financial and operational information. • Effectiveness, efficiency of operations. • Safeguarding of assets. • Compliance with laws, regulations, and contracts. 	Reports for each audit engagement identify risks and opportunities to improve controls. Scope of mandate does refer to the elements of reliability of information, effectiveness & efficiency of operations, safeguarding of assets, and compliance.
2120.A2 - Internal auditors should ascertain the extent to which operating and program goals and objectives have been established and conform to those of the organization.	During engagement planning, business unit plan is reviewed. There is some brief review of its alignment with the broader city objectives.

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PERFORMANCE STANDARDS	
Standard	City of Hamilton
2120.A3 - Internal auditors should review operations and programs to ascertain the extent to which results are consistent with established goals and objectives to determine whether operations and programs are being implemented or performed as intended.	Has been done but not consistently. <i>Recommendation</i>
2120.A4 - Adequate criteria are needed to evaluate controls. Internal auditors should ascertain extent to which management has established adequate criteria to determine whether objectives and goals have been accomplished. If adequate, internal auditors should use such criteria in their evaluation. If inadequate, internal auditors should work with management to develop appropriate criteria.	Performance measures for goals and objectives are identified in business unit plans during planning phase. Enterprise Risk Management has not been formally adopted at the City therefore management has not identified risk tolerance in the various business areas.
2120.C1 - During consulting engagements, internal auditors should address controls consistent with the engagement's objectives and be alert to the existence of any significant control weaknesses.	No policy manual to cover this. <i>Recommendation.</i>
2120.C2 – Internal auditors should incorporate knowledge of controls gained from consulting engagements into the process of identifying and evaluating significant risk exposures of the organization.	Reports for each engagement identify risks and opportunities to improve controls
2130 – Governance Internal audit activity should assess and make appropriate recommendations for improving the governance process in its accomplishment of following objectives: <ul style="list-style-type: none"> • Promoting appropriate ethics and values within the organization. • Ensuring effective organizational performance management and accountability. • Effectively communicating risk and control information to appropriate areas of the organization. • Effectively coordinating activities of and communicating information among the board, external and internal auditors and management. 	Has not been an area of focus for the Internal Audit group.
2130.A1 – The internal audit activity should evaluate the design, implementation, and effectiveness of the organization's ethics-related objectives, programs and activities.	Has not been covered by Internal Audit.

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PERFORMANCE STANDARDS	
Standard	City of Hamilton
2130.C1 – Consulting engagement objectives should be consistent with the overall values and goals of the organization.	Limited consulting is done
2200 – Engagement Planning Internal auditors should develop and record a plan for each engagement, including the scope, objectives, timing and resource allocations.	This is currently being done.
2201 - Planning Considerations In planning the engagement, internal auditors should consider: <ul style="list-style-type: none"> • Objectives of the activity being reviewed and the means by which the activity controls its performance. • Significant risks to activity, its objectives, resources, and operations and means by which potential impact of risk is kept to an acceptable level. • Adequacy and effectiveness of activity’s risk management and control systems compared to a relevant control framework or model. • Opportunities for making significant improvements to the activity’s risk management and control systems. 	Planning documents for each engagement include business understanding. There is no standard format for planning, which could lead to omission of important information, and takes more time to review. Planning documents are reviewed with the Director for each engagement
2201.A1 – When planning an engagement for parties outside the organization, internal auditors should establish a written understanding with them about objectives, scope, respective responsibilities and other expectations, including restrictions on distribution of the results of the engagement and access to engagement records.	N/A – has not happened to date, however there are no policies or procedures in place to address the issue
2201.C1 – Internal auditors should establish an understanding with consulting engagement clients about objectives, scope, respective responsibilities, and other client expectations. For significant engagements, this understanding should be documented.	Minimal consulting work but no consulting assignment would be undertaken without dialogue with business unit to agree scope.
2210 – Engagement Objectives Objectives should be established for each engagement.	Engagement objectives are captured in the planning documents
2210.A1 – Internal auditors should conduct a preliminary assessment of risks relevant to the activity under review. Engagement objectives should reflect the results of this assessment.	Planning for engagements includes a risk assessment, but there is no standardized format.
2210.A2 - The internal auditor should consider the probability of significant errors, irregularities, non-compliance, and other exposures when developing the engagement objectives.	This is captured during planning process

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PERFORMANCE STANDARDS	
Standard	City of Hamilton
2210.C1 – Consulting engagement objectives should address risks, controls, and governance processes to the extent agreed upon with the client.	No policy or procedure for this. <i>Recommendation</i>
2220 – Engagement Scope The established scope should be sufficient to satisfy the objectives of the engagement.	Scope and objectives are documented in planning documents in the file. Scope and objectives are reviewed with the audit director during the planning phase
2220.A1 – Scope of the engagement should include consideration of relevant systems, records, personnel, and physical properties, including those under control of third parties.	Relevant information is captured in the working paper file documents
2220.A2 - If significant consulting opportunities arise during an assurance engagement, a specific written understanding as to the objectives, scope, respective responsibilities and other expectations should be reached and the results of the consulting engagement communicated in accordance with consulting standards.	No policy or procedure for this. <i>Recommendation.</i>
2220.C1 – In performing consulting engagements, internal auditors should ensure that the scope of the engagement is sufficient to address the agreed-upon objectives. If internal auditors develop reservations about the scope during the engagement, these reservations should be discussed with the client to determine whether to continue with the engagement.	Engagement scope would be reviewed by the audit director during the planning phase.
2230 – Engagement Resource Allocation Internal auditors should determine appropriate resources to achieve engagement objectives. Staffing should be based on an evaluation of the nature and complexity of each engagement, time constraints, and available resources.	Director determines amount of time and resources are needed for each assignment
2240 – Engagement Work Program Internal auditors should develop work programs that achieve the engagement objectives. These work programs should be recorded.	Work programs are developed as part of the planning process.
2240.A1 - Work programs should establish procedures for identifying, analyzing, evaluating, and recording information during engagement. Work programs should be approved prior to implementation, and any adjustments approved promptly.	Work programs are documented in the planning documents and are reviewed by the Director.
2240.C1 - Work programs for consulting engagements may vary in form and content depending upon the nature of the engagement.	Work programs are documented in the planning documents.

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PERFORMANCE STANDARDS	
Standard	City of Hamilton
2300 – Performing the Engagement Internal auditors should identify, analyze, evaluate, and record sufficient information to achieve the engagement's objectives.	Files to support reports issued are well documented
2310 – Identifying Information Internal auditors should identify sufficient, reliable, relevant, and useful information to achieve the engagement's objectives.	Files contain sufficient information.
2320 – Analysis and Evaluation Internal auditors should base conclusions and engagement results on appropriate analyses and evaluations.	Reports do not contain conclusions.
2330 – Recording Information Internal auditors should record relevant information to support the conclusions and engagement results.	Files are well documented and are reviewed by the Director.
2330.A1 – The chief audit executive should control access to engagement records. The chief audit executive should obtain the approval of senior management and/or legal counsel prior to releasing such records to external parties, as appropriate.	The Director does control access to the records.
2330.A2 - The chief audit executive should develop retention requirements for engagement records. These retention requirements should be consistent with the organization's guidelines and any pertinent regulatory or other requirements.	All files are stored on site in cabinets.
2330.C1 - The chief audit executive should develop policies governing the custody and retention of engagement records, as well as their release to internal and external parties. These policies should be consistent with the organization's guidelines and any pertinent regulatory or other requirements.	No policies and procedures exist
2340 – Engagement Supervision Engagements should be properly supervised to ensure objectives are achieved, quality is assured, and staff is developed.	Staff meet with Director to work on planning, and throughout audit to provide status updates and seek guidance. Audit files are reviewed by the Director.
2400 – Communicating Results Internal auditors should communicate the engagement results.	An audit report is prepared for every engagement
2410 – Criteria for Communicating Communications should include engagement's objectives and scope as well as applicable conclusions, recommendations, and action plans	Brief outline provided for engagement objectives, and scope, no conclusions. Recommendations are provided.

The City of Hamilton
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Appendix A: Comparison Against IIA Standards

PERFORMANCE STANDARDS	
Standard	City of Hamilton
2410.A1 – Final communication of engagement results should, where appropriate, contain the internal auditor’s overall opinion and or conclusions.	No opinion or conclusion included in reports.
2410.A2 – Internal auditors are encouraged to acknowledge satisfactory performance in engagement communications.	Reports will contain acknowledgement where a department has improved.
2410.A3 – When releasing engagement results to parties outside the organization, the communication should include limitations on distribution and use of the results.	No policies or procedures exist to address the release of engagement results. Confidentiality clauses are not included on the information provided.
2410.C1 – Communication of the progress and results of consulting engagements will vary in form and content depending upon the nature of the engagement and the needs of the client.	Some concerns about communication of issues and changes throughout performance of the audit.
2420 – Quality of Communications Communications should be accurate, objective, clear, concise, constructive, complete, timely.	Some concerns about quality of reports. There is considerable time taken from start of audit to time of issuance of report.
2421 – Errors and Omissions If final communication contains a significant error or omission, the chief audit executive should communicate corrected information to all parties who received the original communication.	No policies and procedures exist to address errors and omissions
2430 – Engagement Disclosure of Non-compliance with the Standards When non-compliance with the Standards impacts a specific engagement, communication of the results should disclose the: <ul style="list-style-type: none"> • Standard(s) with which full compliance was not achieved, • Reason(s) for non-compliance, and • Impact of non-compliance on engagement. 	Policy and procedures do not exist to address this standard
2440 – Disseminating Results The chief audit executive (CAE) should communicate results to the appropriate parties.	Exit interviews are conducted at end of each engagement prior to issuance of a report. Draft reports are issued to business unit leader and other applicable staff to vet and validate results.
2440.A1 - The CAE is responsible for communicating final results to parties who can ensure that results are given due consideration.	The Director provides reports to the SP&B Committee and to CMT.
2440.A2 - If not otherwise mandated by legal, statutory or regulatory requirements, prior to releasing results to parties outside the organization, the chief audit executive should: <ul style="list-style-type: none"> • Assess potential risk to organization. • Consult with senior management and/or legal counsel as appropriate 	A log is not maintained to track requests for information or information released to outside parties. No confidentiality clause is attached to the information released to external parties Dissemination of final results is typically to the business unit head, and SP & B Committee.

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Appendix A: Comparison Against IIA Standards

PERFORMANCE STANDARDS	
Standard	City of Hamilton
<ul style="list-style-type: none"> Control dissemination by restricting the use of the results. 	
2440.C1 - The chief audit executive is responsible for communicating the final results of consulting engagements to clients.	The Director provides reports to the SP&B Committee and to CMT.
2440.C2 – During consulting engagements, risk management, control, and governance issues may be identified. Whenever these issues are significant to the organization, they should be communicated to senior management and Board.	No consulting reports seen.
2500 – Monitoring Progress The chief audit executive should establish and maintain a system to monitor the disposition of results communicated to management.	Internal Audit reviews management’s follow up on findings.
2500.A1 - The chief audit executive should establish a follow-up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action.	Director takes this into account when developing the annual internal audit plan.
2500.C1 – The internal audit activity should monitor the disposition of results of consulting engagements to the extent agreed upon with client.	No consulting reports seen.
2600 – Resolution of Management’s Acceptance of Risks When the chief audit executive believes that senior management has accepted a level of residual risk that may be unacceptable to the organization, the chief audit executive should discuss the matter with senior management. If the decision regarding residual risk is not resolved, the chief audit executive and senior management should report the matter to the board for resolution.	The Director attends at Committee meetings and would identify this when it occurs.

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Appendix B: Recommendations

APPENDIX B: RECOMMENDATIONS

The recommendations have been organized under four primary themes:

- Mandate (Audit Committee and the Internal Audit function);
- Training;
- Execution (of the internal audit work); and
- Reporting (reports provided by the internal audit function).

Each item has been identified as needing attention as follows:

- Immediate (I) meaning within 3 months
- Short Term (ST) meaning within 6 months
- Near Term (NT) meaning within 12 months
- Long Term (LT) meaning within 24 months

#	Recommendation	Pg ⁸	Priority
	Mandate		
1	Update the Internal Audit mandate for changes in reporting lines, the dual reporting lines, and for omissions noted on page 12 of the full report and have it reviewed and approved by Council.	13	I
2	Ensure the Internal Audit mandate is reviewed and updated and taken for approval to Council at the commencement of a new council term.	13	I
3	Update the duties of the Audit Committee as noted on pages 18 and 19 of the full report.	20	I
4	Have Council formally re-assign the duties of the Audit Committee to an appropriate standing committee that has the appropriate focus and breadth of responsibilities.	20	ST
5	Establish at the beginning of each year, dates once per fiscal quarter that the oversight committee will conduct its Audit Committee duties (e.g. April, July, October, and January – these being one month after the quarter end).	21	NT
6	Update the position description for the Director Audit Services to reflect dual reporting lines – administratively to the City Manager, and direct reporting and access to the governance level for the conduct of the Internal Audit work.	22	I
7	Develop a position description for the City Manager role and ensure the responsibilities regarding Internal Audit are clearly articulated and respects that the Director Audit Services has dual reporting lines.	22	I
8	Update the position description for the Director Audit Services to remove inappropriate duties and to encompass more focus on the evaluation of the control environment, risk management, and control activities including delivering on the Internal Audit mandate and supporting the governance level.	23	I
9	Insert a specific duty in the position description for each general manager the following: Responsible for ensuring internal controls in the form of policies, procedures and practices are developed and implemented in relation to the general and specific risks of the area and to achieve the	23	I

⁸ Pg = Page reference in detailed report provided dated September 26, 2005

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Appendix B: Recommendations

	objectives of safeguarding City assets; reliability of management and financial information; compliance with laws and regulations; and efficiency and effectiveness of operations; and ensure that the internal controls operate effectively and continuously.		
	Mandate (cont'd)		
10	Internal Audit mandate clearly specify that it will include all operations directly or indirectly within the operations of the City, specifically all departments, subsidiaries, controlled organizations and agencies.	24	I
11	Expand the Internal Audit mandate to include at least one operational audit per year.	41	I
12	Selection of the individual area for an operational audit should be supported by rationale in terms of potential benefit.	48	ST
13	Include in the Internal Audit mandate that every three years Internal Audit is to survey its stakeholders (i.e. Audit Committee and CMT) on satisfaction of the work and performance of the internal audit department.	53	I
	Training		
14	Provide training/orientation for the members of the standing committee on what is involved in performing the duties of an Audit Committee, as well as training on the role of internal audit (1 st or 2 nd Q 2007), and provide this same training/orientation at the beginning of each council term.	20, 39	NT
15	The Internal Audit function needs focused training on developing the audit universe and the internal audit plan (multi-year and annual), the approach to individual audits, and reporting. We recommend that the City provide focused training for the Internal Audit group as a team on these subjects. The training should be provided by someone knowledgeable of the City's operations as well as the profession of internal auditing. We recommend that the training be executed in three phases, with phase I on site and focused on methodologies and reporting; phase II be comprised of visits by the internal audit staff to other municipalities to see and learn from them; and phase III be the sharing/reviewing of the learnings to develop practices and protocols appropriate for the City of Hamilton.	27	I
16	The Hamilton internal audit professional staff each take two days to spend time learning on site from other public sector internal audit groups. We recommend that the Director visit the City of Edmonton IA group; the Senior Internal Auditor - City of Winnipeg, an intermediate auditor - Region of York, and an intermediate auditor - City of London. This can be counted towards the annual training targets for the members of the audit department. During these on site learning visits, the Hamilton staff should specifically focus on gaining knowledge on how to develop the audit universe and the annual internal audit plan, how to execute an individual audit, and how to report out on the results of internal audits to both senior management and to the governance level. After the field visits the staff to convene to share the learnings in a session facilitated by an outside facilitator, and identify application of the learnings to the City of Hamilton audit work and action plans on implementing such. We are specific on naming the municipalities to be visited and by what level of staff in order to ensure that the appropriate best practices are being sought out.	50	ST

The City of Hamilton
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Appendix B: Recommendations

#	Recommendation		Priority
	Training (cont'd)		
17	Provide training to the General Managers and their staff on the roles and responsibilities of internal audit as well as internal audit's methodologies, reporting protocols and opinions. We recommend that this training occur after Internal Audit has proceeded through its own training and visits to other municipalities and has changed its processes. (1 st Q 2006)	40	ST
	Execution		
18	The annual audit plan to present the full audit universe for the City risk rated at a high level across the eight risk factors.	26	ST
19	The annual audit plan to provide a clear explanation of why specific audit areas in relation to the risk factors have been selected and present at a high level the scope for each of the audits.	26	ST
20	The development of the annual audit plan should consider current year risks. It should not automatically include audits identified in the prior year and not conducted. The Internal Audit mandate should be updated to reflect this.	26	ST
21	Risk-evaluate all potential assignments including the regular recurring assignments. Also consider if the regular recurring work should appropriately be owned by management.	27	ST
22	Following the development of the practices and protocols specific to the City of Hamilton, the Director Audit Services can prepare and present these to the Audit Committee and Corporate Management Team for their awareness and understanding.	29	ST/NT
23	Each field auditor be equipped with a City owned lap top with the Microsoft suite of products and the data interrogation package which the audit group uses.	30	I
24	Provide an annual consulting budget for Internal Audit to engage specialist skills to work under the direction of the Director Internal Audit for the purposes of completing internal audit work.	30	ST
25	Review the salary range for the Senior Internal Auditor with the intent to increase the upper end of the scale in recognition of the position being required to take on a team leader role and the supervision of staff.	32	I
26	The Director should ensure she is sufficiently aware of market comparator data from the private sector to be proactive in dealing with attempts for staff to be enticed away.	32	I
27	The Director Internal Audit to meet with the external auditors to understand the recent changes in the external audit approach particularly as it will include more focus on internal controls and determine if there is a means by which the external auditors can leverage work already being undertaken by the Internal Audit function. The Director can consider if it is possible to modify the audit work within reasonable effort without detracting from an operational wide focus to provide for reliance by the external auditor.	36	ST
28	Increase communication regarding status of the audit and issues identified with the General Managers and their direct reports during the audit	40	ST
29	Transfer some of the regular recurring work back to management (e.g. revenues at Police Services).	48	NT

The City of Hamilton
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Appendix B: Recommendations

#	Recommendation		Priority
Execution (cont'd)			
30	Based on the size of the City of Hamilton, the comparables and the work that the Internal Audit function should be conducting, we recommend increasing the staff complement by 2 full time positions at the senior auditor level (or possibly one at senior auditor level and one at intermediate auditor level) and a consulting budget of \$200,000 be incorporated into the internal audit department's budget for the Director to use in engaging specialized skills.	52	ST
31	The Hamilton Internal Audit department perform a detailed self-assessment of its practices against the IIA standards every three years (to stay aligned with evolving practices).	53	LT
32	The Hamilton department develop a manual for the Internal Audit function that incorporates the mandates, audit approach, protocols, as well as policies (e.g. refraining from auditing where personnel previously had responsibility, access to files).	53	NT
33	Internal Audit to develop a program of quality assurance reviews of its own work.	53	NT
34	The Internal Audit function arrange for a quality assurance review by an accredited firm or by the Institute of Internal Auditors every five years.	53	LT
Reporting			
35	Ensure that the Internal Audit formally reports at each of the quarterly Audit Committee meetings and the External Audit formally reports twice per year (at the planning stage of the audit and at completion).	21	ST
36	In each quarterly report to the Audit Committee the Director Audit Services should specifically state if there have been any impairments to the execution of the audit work.	21	ST
37	A regular monthly or quarterly reporting to the City Management Team regarding the status of audit work and upcoming audits should be provided by the Director Audit Services.	28	I
38	Internal Audit develop improved reporting format considering items outlined in Exhibit VIII.	34	ST
39	Internal Audit to develop a reporting protocol and in it include internal audit opinions as outlined in Exhibit IX.	34	ST
40	The Internal Audit function to change its reporting format to provide the Audit Committee with a quarterly report which summarizes: changes in the City's risk profile as identified by Internal Audit, progress on the annual audit plan as approved by the Committee, summaries of the reports issued in the quarter, and a conclusion on trends that the function is observing through its work.	38	ST