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STATE OF CALIFORNIA
Office of the Auditor General

Thomas W. Hayes
Auditor General

660 J STREET, SUITE 300
SACRAMENTO, CA 95814

September 24, 1987

Mr. Gerald A. Silva
City Auditor
151 W. Mission Street, Room 109
San Jose, California 95110

Dear Mr. Silva:

We have reviewed the system of quality control in effect as of June 30, 1987, for audits issued by the City Auditor for the City of San Jose and have issued a separate management letter thereon dated September 23, 1987. As specified in our engagement letter dated April 6, 1987, our review was limited to an assessment of personnel and audit administration procedures and controls to ensure conformity with the standards specified in the National State Auditors Association's (NSAA) "Quality Review Guidance for Government Audit Organizations." Since your quality control procedures were not implemented until April 1, 1987, we did not conduct substantive testing of the implementation of the quality control procedures.

In performing our review, we have given consideration to the general characteristics of a system of quality control as described in the guidelines issued by the NSAA. Such a system should be sufficiently comprehensive and designed to ensure production of reliable audits given the audit organization's structure, legal requirements, policies, and the nature of its functions.

In our opinion, the system of quality control for the City Auditor of the City of San Jose in effect as of June 30, 1987, met the objectives of the quality control guidelines issued by the NSAA. Furthermore, in our opinion, the office of the City Auditor's adherence to its system of internal controls should provide reasonable assurance that the office's work will conform to professional standards.

Sincerely,


THOMAS W. HAYES
Auditor General

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September 24, 1987

Mr. Gerald A. Silva
City Auditor
151 W. Mission Street, Room 109
San Jose, California 95110

Dear Mr. Silva:

We have reviewed the system of quality control for audits issued by the City Auditor for the City of San Jose in effect as of June 30, 1987, and have issued a separate report dated September 24, 1987, on our review of that system. This letter should be read in conjunction with that report.

During our review, we did not note any material weaknesses that we believe are essential for an adequate system of quality control. However, we noted a few areas where you could enhance your existing system of quality control to provide a more efficient implementation of the audit process.

BACKGROUND

The City Auditor for the City of San Jose is responsible for providing performance audits, financial audits, and special studies. Under the present organizational structure, the staff of the City Auditor conducts performance audits and special studies. The City Auditor serves as the contracting agent to procure the required financial audit services and procures special study services that require specialized or unique skills or experience. Our review was limited to evaluating the City Auditor's system of quality control in place as of June 30, 1987, for conformance with the Standards for Audit of Governmental Organizations, Programs, Activities, and Functions issued by the Comptroller General of the United States.

We have performed our review of your system of quality control in accordance with the scope outlined in our engagement letter dated April 6, 1987. Since your quality control procedures were not implemented until April 1, 1987, we did not conduct substantive testing of the implementation of the quality control procedures. To assess the quality control policies and procedures, we used the "Quality Review Guidance for Government Audit Organizations" recommended by the National State Auditors Association. Mr. Thomas A. Britting, Audit Manager, with the Office of the Auditor General, conducted the actual review. Mr. Britting has extensive performance audit experience with both the United States General Accounting Office and the Office of the Auditor General of the State of California.

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City Auditor
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RECOMMENDATIONS

The following recommendations are made to enhance the City Auditor's existing system of quality control to provide for a more efficient implementation of the audit process.

1. The City Auditor procures financial audits under contract with certified public accounting firms. The contracts presently used by the City Auditor clearly outline the contractors' audit responsibilities and the professional standards that the contractors must follow. The contracts are prepared by the City Attorney with consultation from the City Auditor. Under current procedures, prior year contracts serve as a model for subsequent year contracts. Although the City Auditor has followed this procedure, the procedure is not clearly stated in the Operations Manual. The City Auditor has recognized the need for improving procedures in this area and was working on developing procedures for financial audit standards during the course of our review. Therefore, we recommend that the City Auditor complete the development of procedures that a contractor must follow to ensure adherence to professional standards and incorporate these procedures into the Operations Manual.
2. The City Auditor requires the audit staff to provide assurances that they meet the standards of independence at the beginning of each engagement. However, during an engagement, situations may arise that may impede the auditor's independence. To allow for such situations, Generally Accepted Government Auditing Standards place responsibility on the individual auditor to inform management if such an event takes place. The City Auditor's existing procedures are silent on this issue. Therefore, we recommend that the City Auditor add to the Operations Manual a procedure placing responsibility on the audit staff for informing management of any events that may call into question the auditor's independence.
3. The City Auditor's procedures adequately address the standards of evidence required of governmental auditors. One of those standards requires that an auditor seek corroboration of testimonial evidence when the auditor must rely on statements made by the auditee to support critical elements of an audit finding. At times, we have experienced situations where no corroborative evidence exists and reliance on interviews could

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lead to disputes because of the potential for miscommunication. To enhance the reliability of testimonial evidence, we recommend that the City Auditor adopt a procedure requiring audit staff to obtain letters of representation from auditees when the auditors must rely on uncorroborated testimonial evidence.

4. Generally Accepted Government Auditing Standards require audit organizations to maintain a training program that maintains and enhances the auditing skills of professional staff. The City Auditor adequately addresses this standard by annually evaluating the specific training needs of each auditor and obtaining the necessary training within the budget constraints for training. Recent recommended draft revisions to government auditing standards would specify a minimum of 80 hours of continuing professional education each two years with at least 24 hours in government-related auditing subjects. Should this revision be adopted, we recommend the the City auditor make provision to provide the required level of training prescribed by the standards.

This management letter is intended solely for the use of the City Auditor for the City of San Jose and should not be used for any other purpose except at the discretion of the City Auditor. We appreciate the cooperation and assistance extended by the management and staff of the City Auditor.

Sincerely,


THOMAS W. HAYES
Auditor General

CITY OF SAN JOSÉ, CALIFORNIA



GERALD A. SILVA
City Auditor

151 W. MISSION STREET, ROOM 109
SAN JOSE, CALIFORNIA 95110
(408) 277-4601

September 28, 1987

Mr. Thomas W. Hayes
Office of the Auditor General
660 J Street, Suite 300
Sacramento, CA 95814

Dear Mr. Hayes:

Thank you, Mr. Kurt Sjoberg, and Mr. Tom Britting, for conducting this Office's first peer review performance audit. As you know, City Charter Section 805.2 requires that a performance audit of the City Auditor's Office be conducted and reported to the full City Council just before the mid-point and conclusion of the City Auditor's four-year appointment. Because your review was in accordance with the standards specified in the National State Auditors Association's "Quality Review Guidance for Government Audit Organizations," this Office was able to meet its statutory requirement.

I was very impressed with Mr. Britting's professional approach and thoroughness. His guidance and recommendations will enhance our quality control system and better prepare us for future peer reviews. Your recommendations are appropriate and we are taking the following steps to implement them:

1. Procurement of outside financial audit services:

Our operating procedures 4-07, "Contracting for Services," provides for the contracting of outside professional services. However, it does not specifically address the procurement of financial audit services or provide the required audit contract boilerplate. Both of these elements will be included in the revised procedure.

2. Standards of independence:

Our operating procedure 4-01, "Job Number and Staff Assignment," addresses the identification of auditor impairments at the job assignment phase of each audit. It will be revised to also require staff to advise management during the audit should an impairment develop that might

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impede the auditor's independence. All audit staff have already been informed of their responsibility to report any situations that may arise during an assignment that may impair their independence.

3. Standards of evidence:

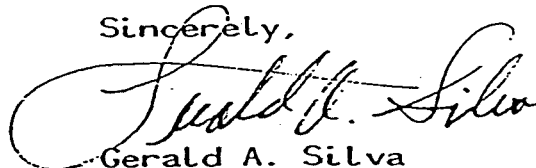
Our operating procedure attachment 5-05.1, "Rules of Evidence," addresses the use and risk of using interviews as evidence. Although this Office uses letters of representation, they have not been specified in policy. We will revise attachment 5-05.1 to address this shortcoming.

4. Continuing professional education hours:

Our operating procedure 2-04, "Staff Training/ Continuing Education," provides for training for all staff. We are aware of the proposed standard for auditors of 80 continuing education hours every two years with at least 24 hours in government-related auditing subjects. Should the GAO adopt the standard, we will revise our procedure accordingly.

Again, Jeff Mikles and I sincerely appreciate your timely assistance in this very important matter and are pleased with the results of your review.

Sincerely,



Gerald A. Silva
City Auditor

GS:b