San Diego Chapter of the Institute of Internal Auditors

Driving Value – Innovative Approaches to Internal Audit

Presented by:
Mark Steranka, Director
Ryan Luetkemeyer, Senior Manager

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OVERVIEW

I. Introductions
II. ROI-Based Reporting
III. Lean accounting
IV. Questions and Answers
I. INTRODUCTIONS

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Director
National Performance Audit Practice Leader

Ryan Luetkemeyer, CPA
Senior Manager, Government and Not-For-Profit Services Practice
ROI-Based Reporting
ROI-BASED APPROACH

• Scope of Services
• Program Structure
• Program Cycle
• Identifying Opportunities
• Estimating Potential ROI
• Tracking/Reporting ROI
• Leveraging Performance Metrics
Areas of Focus: accounting and financial reporting, asset management, capital programs, compliance, economics and funding, fraud, governance, human resources, internal controls, maintenance and operations, management, operations and service delivery, organization and staffing, processes and procedures, procurement, public safety, risk management, and technology
PROGRAM STRUCTURE

• Audit Committee recommends annual audit program composition and accepts work products
• Board/Council authorizes expenditures and adopts work products
• Internal Audit reports monthly to Audit Committee on project status and results
• Internal Audit reports quarterly to Board/Council on program status and results
• Internal Audit reports annually to Audit Committee and Board/Council on program ROI
PROGRAM CYCLE

1. Enterprise Assessments
2. Internal Audits
3. Management Actions
4. Monitoring & Review
## IDENTIFYING OPPORTUNITIES – RISKS

<table>
<thead>
<tr>
<th>Areas of Focus</th>
<th>Risk Level</th>
</tr>
</thead>
<tbody>
<tr>
<td>Governance</td>
<td>Low</td>
</tr>
<tr>
<td>Economic</td>
<td>Moderate – High</td>
</tr>
<tr>
<td>Operations</td>
<td>Moderate – High</td>
</tr>
<tr>
<td>Human Resources</td>
<td>High</td>
</tr>
<tr>
<td>Asset Management</td>
<td>Moderate – High</td>
</tr>
<tr>
<td>Internal Control</td>
<td>Low – Moderate</td>
</tr>
<tr>
<td>Management</td>
<td>Low – Moderate</td>
</tr>
<tr>
<td>Emergency Preparedness</td>
<td>Moderate – High</td>
</tr>
<tr>
<td>Technology</td>
<td>Moderate</td>
</tr>
<tr>
<td>Compliance</td>
<td>Low</td>
</tr>
<tr>
<td>Risk Management</td>
<td>Low – Moderate</td>
</tr>
<tr>
<td>Procurement and Supply Chain</td>
<td>Low</td>
</tr>
<tr>
<td><strong>OVERALL AGGREGATED RISK</strong></td>
<td><strong>MODERATE-HIGH</strong></td>
</tr>
</tbody>
</table>
IDENTIFYING OPPORTUNITIES – RISKS

- Governance
- Internal Control
- Regulatory Compliance
- Asset Management
- Supply Chain
- Financial, Accounting, and Reporting
- Human Capital
- Operations
- Management
- Technology
- Economic

0 0.5 1 1.5 2 2.5 3 3.5 4 4.5 5
# Identifying Opportunities – Risks

<table>
<thead>
<tr>
<th>Risk Factors</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk Level</td>
<td>Level of uncertainty</td>
</tr>
<tr>
<td>Likelihood</td>
<td>Probability of a negative event occurring</td>
</tr>
<tr>
<td>Impact</td>
<td>Level of significance should a negative event occur</td>
</tr>
<tr>
<td>Risk Trajectory</td>
<td>Direction of where risk is headed in the future</td>
</tr>
<tr>
<td>Condition</td>
<td>Causes and impacts of identified risk</td>
</tr>
<tr>
<td>Risk Mitigation</td>
<td>Actions and projects</td>
</tr>
<tr>
<td>Potential Residual Risk (if risks are mitigated)</td>
<td>Level of uncertainty</td>
</tr>
</tbody>
</table>
IDENTIFYING OPPORTUNITIES – E/E/E

• Is your department meeting your bottom line commitments to the public?
• Is your department operating at a minimum "mission critical" level?
• Does your department have service level metrics/KPIs and standards?
• Within your department, what excess capacity (related to personnel workloads) exists, if any?
• Within your department, what duplicate tasks/overlaps exist?
• Within your department, what significant processes and business practices require improvement?
• Within your department, what manual processes could be strengthened if automated?
• What organizations/staffing can be consolidated?
• What departments/functional areas need to better connect (integrate)?
• What major contracts (over $100,000) do you have in place?
• Does your department conduct price and cost analysis for major contracts and purchases?
## IDENTIFYING OPPORTUNITIES – E/E/E/E

<table>
<thead>
<tr>
<th>Project Elements</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Observations</td>
<td>Description of opportunities to improve</td>
</tr>
<tr>
<td>Recommendations</td>
<td>How to proceed and why</td>
</tr>
<tr>
<td>Audit Objectives</td>
<td>Focus of project</td>
</tr>
<tr>
<td>Scope of Work</td>
<td>Scope of project (phases and tasks)</td>
</tr>
<tr>
<td>Schedule</td>
<td>Project schedule</td>
</tr>
<tr>
<td>Budget</td>
<td>Project costs</td>
</tr>
</tbody>
</table>
ESTIMATING POTENTIAL ROI

- Reduced external costs (contracts)
- Reduced staffing levels (existing and future)
- Increased cost recovery
- Increased revenue
## TRACKING/REPORTING ROI

<table>
<thead>
<tr>
<th>Project</th>
<th>Project Costs</th>
<th>Potential Savings</th>
<th>Potential ROI</th>
<th>Actual Savings</th>
<th>Actual ROI</th>
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</thead>
<tbody>
<tr>
<td>Risk Assessment/ Meetings</td>
<td>$40,000</td>
<td>$0</td>
<td>n/a</td>
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<tr>
<td>Public Defender Study</td>
<td>$20,000</td>
<td>$95,000 - $369,000</td>
<td>5/1 to 18/1</td>
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<tr>
<td>Community Golf Study</td>
<td>$20,000</td>
<td>$50,000 - $100,000</td>
<td>3/1 to 5/1</td>
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<tr>
<td>Community Facilities Study</td>
<td>$15,000</td>
<td>$30,000 - $60,000</td>
<td>2/1 to 4/1</td>
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<tr>
<td>Fleet Efficiency Study</td>
<td>$55,000</td>
<td>$174,000</td>
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<tr>
<td>Fleet Utilization Study</td>
<td>$30,000</td>
<td>$92,000</td>
<td>3/1</td>
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<tr>
<td>FWA Program</td>
<td>$25,000</td>
<td>$0</td>
<td></td>
<td></td>
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<tr>
<td>Performance Metrics</td>
<td>$30,000</td>
<td>$0</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Total</td>
<td>$235,000</td>
<td>$441,000 - $795,000</td>
<td>2/1 to 3/1</td>
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# TRACKING/REPORTING ROI

<table>
<thead>
<tr>
<th>Reports</th>
<th>Reporting Entity</th>
<th>Findings</th>
<th>Completed</th>
<th>Costs</th>
<th>Savings</th>
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<tbody>
<tr>
<td>Internal Audit</td>
<td>City Auditor</td>
<td>36</td>
<td>13</td>
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<tr>
<td>2010 Report to Management of Internal Controls</td>
<td>Macias, Gini, O'Connell</td>
<td>3</td>
<td>1</td>
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<td>2011 Memorandum of Internal Control for CAFR</td>
<td>Maze &amp; Associates</td>
<td>38</td>
<td>21</td>
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<td>2010 Single Audit</td>
<td>Macias, Gini, O'Connell</td>
<td>8</td>
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<td>2011 Single Audit</td>
<td>Maze &amp; Associates</td>
<td>5</td>
<td>4</td>
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<td>2011 Audits</td>
<td>State Controller's Office</td>
<td>13</td>
<td>9</td>
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<td>2012-13 Grand Jury Report</td>
<td>Grand Jury</td>
<td>30</td>
<td>18</td>
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<td>2012 Agreed Upon Procedures Engagement - RDA</td>
<td>Brown Armstrong</td>
<td>5</td>
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<td>2013 Moss Adams Internal Control Review</td>
<td>Moss Adams LLP</td>
<td>70</td>
<td>0</td>
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<td>2012 SAS 115 - Internal Controls Identified in an Audit</td>
<td>Pun &amp; McGeady</td>
<td>11</td>
<td>0</td>
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<tr>
<td>Total</td>
<td></td>
<td>219</td>
<td>78</td>
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</table>
LEVERAGING PERFORMANCE METRICS

- Community needs & results
  - Community condition & outcome measures
- Programs & services aligned with needs
  - Program outcome, output, & efficiency measures
- Individual activities aligned with programs & services
  - Individual outcome, output, & efficiency measures

Strategic Plan, Objectives, Strategies, & Targets
LEVERAGING PERFORMANCE METRICS

For each Department/Function:

• Objective

• Outcome Measure
  ○ Program or service effectiveness

• Efficiency Measure
  ○ Program or service productivity
  ○ Unit cost

• Strategic Goals Impacted
Lean Accounting
INTRODUCTION

• My story and experiences in government
  o My clients in CA, WA, NM
  o Two recent experiences
  o Feedback I receive at GFOA, NAFOA, others
  o Stories I hear from finance directors, council members, department directors, and internal auditors
  o #1 wish – That the audit process (both internal and external) provided more value

• Case studies from other governments
  o Embracing or recommending “lean principles”
THE VISION OF LEAN

• Recent examples of how internal audit helps provide value?
• Report by McKinsey and Co. (International Management Consulting Co.)
  o “Growth and Renewal in the US – Retooling America’s Economic Engine”
  o Identified seven major imperatives that the US needs to meet if it is to achieve the productivity growth needed
  o #1 – Drive productivity gains in the public and regulated sectors
THE VISION OF LEAN - CONTINUED

• Lean principles, anyone heard of it?
  o Lean refers to a collection of principles and methods that focuses on identifying and eliminating non-value-added activities (waste) involved in producing a product or delivering a service to customers
  o Gradual, continuous improvement
  o Implementation-oriented
  o Customer-focused
THE VISION OF LEAN - CONTINUED

• Many are skeptical of Lean
  o Believe their departments/programs have really good systems already
  o Frustrating to talk about waste in government taxpayer money
  o Hard to talk about Lean during budget crunches

• “The most dangerous kind of waste is the waste we do not recognize” – Shigeo Shingo from Toyota

• Waste is unique to Lean, wait time, what else you could do, etc.
  o Doesn’t mean you are bad employee or bad manager
THE VISION OF LEAN - CONTINUED

• Lean principles, anyone heard of it?
  o Infuses employees at all levels in the improvement process
  o Taps the resources, knowledge, skills, abilities of all people in the process
  o Allows all employees to have buy in and ownership of the process
  o Bottom up

• Lean is a win-win-win
  o Employees
  o Customers
  o Taxpayers
CASE STUDIES

• Success stories all over You Tube
• City of Cape Coral, FL
• Public Works Service Division
  o Drainage swales assistance
  o Reduced waiting time from 2 years to 6 month
  o Changes in driveway method of reconstruction yielding a cost avoidance burden $4,750
  o 48 hr driveway use vs. 168 hr vs. old method
• Community Development/Building Division
  o Time to obtain a permit reduced from 21 days to 8 days
City of Cape Coral, FL
  - Human Resources, in conjunction with the Fire Department
  - Reduced time to hire new firefighters from 66.5 days to 30 days

Washington State
  - Department of Transportation, customer focused
  - Looked for where are the opportunities to set up DOT for success
    - Where are people waiting, backlogs
CASE STUDIES - CONTINUED

• Washington State
  o Traffic Sign Fabrication program
  o People run into signs, weather blows over signs, signs are old and not enough money to replace them
  o Reduced volatility in the way they order their signs, emergency orders, and standardize order process
  o 20% reduction in costs and 45% reduction in routine sign order lead time
CASE STUDIES - CONTINUED

• Washington State
  o Department of Transportation
  o Traffic sign project was successful so they looked at collision processing
  o Used visual mapping, found each employee spends 13 minutes on each accident report. The wasted time was waiting for others to provide information.
  o They reduced their current collision processing time by 26%, which will be used to reduce the 8 month backlog
CASE STUDIES - CONTINUED

• Washington State
  o Department of Commerce
    ▪ 100 programs but found only 4 core processes, grants and loans and 3 other services
    ▪ Focused on grants and loans, developed heat map identifying risk areas
    ▪ Built framework from top/down approach to determine priority areas
    ▪ Sound familiar?
    ▪ Director hadn’t heard of anyone else doing this in state government

• Do you consider value-added or efficiency producing areas in your risk assessment? Please provide examples.
SUMMARY

• Improve communication between departments
• Get all employees involved in making improvements
• Start answering the question, how can internal audit help implement Lean principles in your organization?
• Start small, find ways to include Lean approaches into your Internal Audit plan