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**SENT VIA: [city.council@cityofpaloalto.org](mailto:city.council@cityofpaloalto.org)**

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**TO:** Eric Filseth, Palo Alto Mayor  
Adrian Fine, Palo Alto Vice Mayor  
Alison Cormack, Council Member  
Tom DuBois, Council Member  
Liz Kniss, Council Member  
Lydia Kou, Council Member  
Greg Tanaka, Council Member

**RE: *Internal Audit Practices: City of Palo Alto Relative to Industry Practices***

The Institute of Internal Auditors (IIA) recently reviewed the report prepared by Kevin W. Harper CPA & Associates titled “Internal Auditing Practices: City of Palo Alto Relative to Industry Practices.” Based on the report and its recommendations, we understand that the Palo Alto City Council is considering a change in the reporting structure for internal audit. This would include having the city auditor report to the city manager rather than to the City Council. The IIA, as the standard-setter for the internal audit profession in the United States and worldwide, is concerned that these changes would undermine the independence and critically important role of internal audit in Palo Alto, negatively impacting the public’s interest.

We believe that the City of Palo Alto should maintain the current reporting structure of its internal audit function to continue to provide objective insights, improve efficiency of operations, assess controls, evaluate risk and protect assets, and ensure compliance with laws and regulations.

An independent audit function, as articulated in the widely accepted *International Standards for the Professional Practice of Internal Auditing*, enhances accountability to taxpayers and helps to ensure that public funds are properly spent. If structured and staffed appropriately, an independent audit department can proactively prevent problems by

evaluating controls through regular reviews. Because an internal audit function is more familiar with city operations and processes, it is quicker to respond to requests and available to follow up on recommendations and implementations.

To ensure the City's internal audit function remains independent, objective, appropriately staffed, has an appropriate reporting structure, and functions in conformance with professional *Standards*, we recommend the following:

**Internal Audit Needs to Be Supported by the City Council and City Management.**

It is vital that the City Council drive a culture in which all city employees understand the importance and value of the internal audit function. This includes building an internal audit function based on identifying the most effective ways for the city to deliver on its mission and objectives.

The City Council must embrace the importance of independence and objectivity. A properly resourced internal audit function, independent from management, can provide insightful recommendations on how to achieve objectives more effectively, ensure mitigation of related risks, and safeguard taxpayer dollars.

Although internal audit may discover ineffective and inefficient processes and practices and recommend corrective actions, the City Council and city management must resist any temptation to box in internal audit or diminish its role when friction might occur. Instead, and in the public interest, all must remain committed to supporting the inherent benefits of independent and objective assurance, which internal audit provides.

**Internal Audit Needs to Be Independent.**

Independence is the freedom from conditions that threaten the ability of the internal audit activity to carry out its responsibilities in an unbiased manner. To achieve the degree of independence necessary to effectively carry out these responsibilities, the chief audit executive must have direct and unrestricted access to both city management and the City Council. The City Auditor must also be free from any undue influence of city management. This influence can appear in many forms, including inappropriate administrative or functional reporting relationships, budgetary constraints, and decision-making around personnel issues (e.g., hiring/firing and compensation).

**Internal Audit Needs to Be Objective.**

Objectivity is demanded in the *Standards*, ensuring internal auditors' work is of high quality and is not compromised. Objectivity requires that internal auditors do not subordinate their judgment on audit matters to others.

**Internal Audit Needs to Be Appropriately Resourced.**

The chief audit executive must ensure that internal audit resources are appropriate, sufficient, and effectively deployed to achieve stated objectives included in the audit plan. Appropriate refers to the mix of knowledge, skills, and other competencies needed to perform the audit plan. Sufficient refers to the quantity of resources needed to accomplish the plan. Resources are effectively deployed when they are used in a way that optimizes

the achievement of the approved plan. Staffing decisions should be at the discretion of the appointed City Auditor and should not be subject to influence from city management.

**Internal Audit Needs an Appropriate Reporting Structure.**

The chief audit executive must report to a level within the city that allows the internal audit activity to fulfill its responsibilities. In a municipal environment, this is appropriately achieved by appointment of the City Auditor directly by the City Council. Alternatively, the City Council may choose to establish an independent audit committee comprising a majority of independent citizens. In either case, the City Council (or the independent audit committee) maintains full responsibility of the appointment and performance of the City Auditor, similar to the reporting relationship the City Manager maintains with the City Council. The City Council should view the internal audit function as its primary partner in providing effective and independent oversight of city operations.

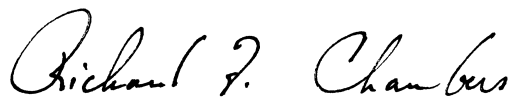
**Internal Audit Needs to Function in Conformance with Professional Standards.**

Professional *Standards* for the practice of internal auditing, contained in the *International Professional Practices Framework* (IPPF) or Red Book, have been adopted, fully embraced and referenced by organizations across the globe, including the Basel Committee on Banking Supervision (BCBS), the United States Federal Reserve, federal, state and local government entities, and publicly traded and privately held organizations of all sizes. Conformance to the *Standards* strengthens the delivery of internal audit services, which in turn helps improve governance, manage risks, and implement controls to more effectively achieve established organizational goals.

The IIA is dedicated to supporting quality, professional, and ethical practices across all industries and public enterprises. The IIA encourages the City Council to familiarize itself with the attached *OnRisk 2020* report. While this report is based on data from the corporate sector, the findings are relevant across all sectors and may serve to better inform the City Council on the important and distinct roles necessary for effective risk management: the Board (City Council), management, and independent internal audit.

We welcome the opportunity to provide additional guidance or information to assist the City Council as it deliberates this issue. Please contact Kathy Anderson, The IIA's Managing Director of North American Advocacy, at [kathy.anderson@theiia.org](mailto:kathy.anderson@theiia.org) or 407-937-1291 if you have any questions or would like to discuss further.

Sincerely,



Richard F. Chambers, CIA, QIAL, CGAP, CCSA, CRMA  
President and Chief Executive Officer

Attachment: *OnRisk 2020*: A Guide to Understanding, Aligning, and Optimizing Risk