



CITY OF CAPE CORAL

City Auditor's Office

TO: Audit Committee and City Council

FROM: Andrea R. Russell, City Auditor *arl*

DATE: June 24, 2026

SUBJECT: The Importance of Internal Audit in Navigating Heightened Financial and Operational Risk

Background

State and local governments are operating in an environment with heightened risk requiring increased oversight due to financial pressure, rapid regulatory change, and amplified public scrutiny. Many jurisdictions across the country are now reporting increased “fiscal stress” as revenue growth tapers off and federal pandemic aid winds down, pushing cities from a brief period of recovery into a phase of budgetary restraint. Many factors contribute to this environment including economic uncertainty looming from the proposed changes to property taxes. These local pressures are occurring amid broader economic uncertainty, with economists noting elevated risk related to inflation, household debt levels, and a slowdown in key sectors such as construction, real estate, and tourism, even where headline revenue forecasts appear stable. These potential funding issues place additional scrutiny on what some may consider fewer essential functions of the City such as infrastructure over public safety. The potential changes in funding to the City can increase the risk of misstatements, control breakdowns, inefficient use of public resources and fraud. In this context, the City faces a real possibility of having to do more with less for an extended period. This heightens the importance of strong governance, transparent reporting, and proactive risk management.

Economic Outlook and Fiscal Risk

Although forecasts may project modest revenue growth at the state level, experts consistently emphasize that uncertainty about the economic outlook remains elevated. This results in continued inflationary pressure, reduction in household savings, and increased reliance on consumer credit. For cities, national surveys show that revenue growth is slowing down and that many finance officers expect declining fiscal flexibility over the next few years. This will lead to delayed or downsized capital projects, tighter operating budgets, and increasing strain on public services. This more somber outlook means that fiscal and operational risk is expected to remain elevated over time, rather than prove temporary.

Heightened Fraud and Misconduct Risk

Local governments are not immune to significant fraud, waste, and abuse. Recently, hundreds of embezzlement and corruption incidents at the city and county levels have been identified, with individual schemes sometimes reaching into the tens of millions of dollars. Smaller and mid-sized jurisdictions are often particularly vulnerable because limited staffing, turnover, and budget pressures can lead to inadequate segregation of duties, weak oversight, and reliance on informal workarounds. During periods of fiscal stress, the pressure to “get things done” with fewer resources can increase the risk of management overrides, procurement irregularities, manipulation of financial results, and misuse of grant or restricted funds, making a strong and independent internal audit function even more critical.

AICPA¹ Perspective: Strong Internal Control and Risk-Based Assurance

The AICPA emphasizes management and those charged with governance are responsible for preparing reliable financial information and maintaining effective internal control over financial reporting. This should be supported by a robust system of risk assessment and governance. Recent AICPA guidance and standards stress a proactive, risk-based approach to quality management and risk assessment to address the increasing complexity of financial reporting and the need to identify and respond to risks of material misstatement.

Internal audit directly supports these objectives by:

1. Evaluating the design and operating effectiveness of internal controls over key financial processes, including budgeting, revenue recognition, grants management, procurement, and payroll.
2. Providing independent, risk-based assurance over areas with heightened susceptibility to error or fraud, in alignment with risk assessment and quality management expectations.

These activities help ensure that key financial decisions are supported by reliable information. This also helps to ensure that weaknesses are identified and remediated in a timely manner to allow our external auditors to conduct their audits more efficiently and effectively.

IIA² Perspective: Independence, Three Lines Model, and Crisis Resilience

The IIA's principles highlight internal audit as the independent "third line" that provides objective assurance and advice on the effectiveness of risk management, internal controls, and governance across the organization. In times of crisis or elevated risk, the

¹ American Institute of Certified Public Accountants is the national professional organization for Certified Public Accountants in the United States.

² Institute of Internal Auditors is the global professional association that establishes standards and provides guidance for the internal audit profession.

IIA stresses that internal audit's independence and objectivity protected through direct accountability to City Council and the Audit Committee, access to information, and adherence to professional standards and a code of ethics are especially critical.



From the IIA perspective, an effective internal audit function:

1. Provides unbiased assurance over the first and second lines, confirming whether risks are being identified, assessed, and managed in line with the organization's risk appetite and public expectations.
2. Maintains flexibility and responsiveness in crisis situations, offering real time insights and advisory input while preserving independence by avoiding management decision making roles.
3. Helps ensure that crisis management, business continuity, and emergency response plans are properly designed, tested, and aligned with overall objectives, rather than remaining "plans on paper."
4. Reinforces a culture of integrity, accountability, and ethical conduct throughout the organization by applying a disciplined, systematic approach and an unyielding commitment to a code of ethics.

This independent role becomes even more important when fiscal stress increases pressures on staff, systems, and controls, creating conditions where control overrides or shortcuts may be more likely. In a prolonged environment of fiscal stress and policy uncertainty, internal audit also serves as an early warning system, identifying patterns of budgetary strain, control overrides, or ethical lapses before they escalate into high profile failures that damage public trust.

Importance of Internal Audit for State and Local Governments

Professional guidance for governmental auditors underscores that robust audit and assurance functions are essential to ensuring transparency, efficiency, effectiveness, and accountability in government. This guidance calls for risk-based planning, strong independence, adherence to professional standards, effective communication with stakeholders, and systematic follow-up on recommendations. All these areas are affected by a well-supported internal audit function.

This means The City Auditor's Office can:

1. Prioritize high risk areas such as revenue volatility, capital projects, grant compliance, vendor and contract management, information technology and cybersecurity, and programs serving vulnerable populations.
2. Engage with City Council and department leadership to help understand risk concerns and focus audit and assurance work on what matters most.
3. Use data analytics and technology to detect anomalies and emerging risks earlier, improving both efficiency and impact of audit work.
4. Monitor and report on the status of corrective actions from audit recommendations, supporting sustained improvements rather than one-time fixes.

By aligning with AICPA and IIA expectations, internal audit becomes a visible demonstration of the City's commitment to good governance and sound stewardship of public funds. As cities transition from temporary pandemic era support to a more constrained, high risk fiscal environment, a well-supported internal audit function becomes one of the primary safeguards against both financial deterioration and fraudulent or abusive practices.

How Internal Audit Supports the Audit Committee and City Council

Both the AICPA and IIA frameworks envision internal audit as a key resource for those charged with governance. For the Audit Committee and City Council, an empowered City Auditor's Office provides:

1. Independent assurance that key risks (financial, operational, compliance, and strategic) are being managed effectively.
2. Insight into the adequacy of the City's internal controls and risk management processes, including whether control deficiencies and audit findings are resolved promptly and effectively.
3. Early warning on emerging risks, such as cybersecurity incidents, funding shifts, or control breakdowns in high volume transactions.
4. Clear, concise reporting that supports informed oversight, budget and policy decisions, and transparent communication with constituents.

These contributions strengthen the Audit Committee's and Cape Coral Council's ability to fulfill their fiduciary responsibilities and to demonstrate accountability to the public.

MISSION

To enhance and protect organizational value by providing independent, risk-based objective assurance, advice, and insight to the City.

RISK | INSIGHT | ASSURANCE

VISION

To partner with the City Council, City Management, and the Community without compromising independence, objectivity, or integrity in order to be the City's trusted advisor.

PARTNERSHIP | PEOPLE | TRUST

Conclusion:

The City Auditor's Office is a valuable resource during uncertain and changing times. We are here to provide independent assurance on day-to-day City activities as well as strategic and long-range plans and functions. We help to enforce accountability by actively performing our mission and embracing our vision.