

LOCAL FOCUS

A Publication of the League of Oregon Cities



JANUARY 2011

2011 Legislative Session Begins

LOCAL ISSUES: LOCAL DECISIONS

An Open Letter to State Leaders

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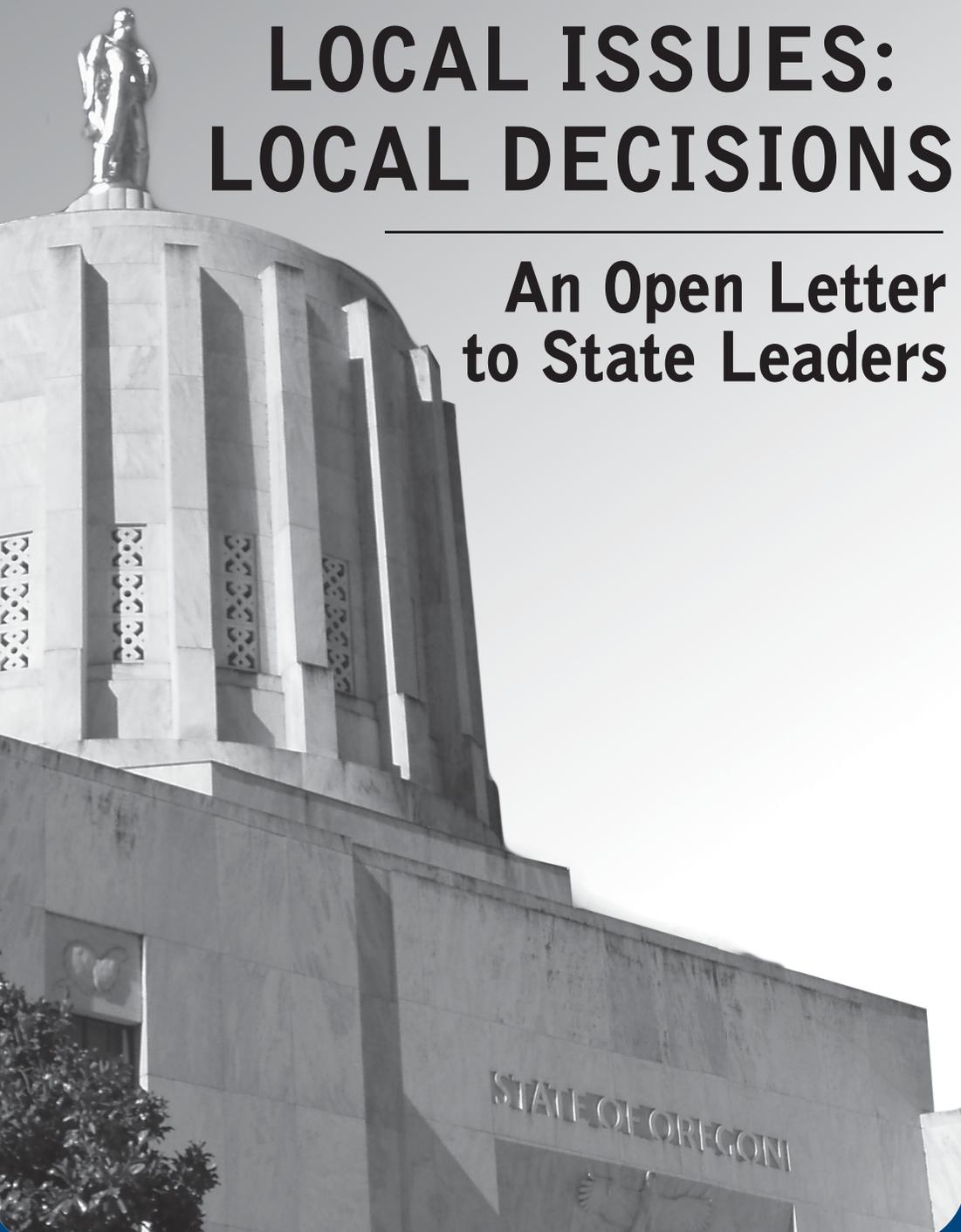
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AUDITS:

What City Elected Officials Should Know

By Richard Seals, CPA CMA CFM

It happened at the city of West Linn in the early 2000s; and it can happen at your city. Audits stopped occurring, the auditors disengaged, and the finance director commenced a monthly embezzlement scheme lasting five years. It wasn't until a new city manager reengaged the auditing process in 2006 that this embezzlement scheme was discovered. It wasn't until 2010, once the audits were all caught back up, that the city's credit ratings were restored and necessary bond refundings were completed. What should the elected officials have been aware of? What should they have done? What would you have done?

In the State of Oregon, annual audits are due to the Audits Division of the Secretary of State's Office by December 31. Audit responsibility starts with the city's finance director then trickles down to the city manager, then to the audit committee, and finally rests with elected officials. Annual audits exist for the purpose of financial accountability. The lack of audits or a poor auditing process are accountability failures for which everyone is responsible.

Know What an Audit is...and What it is Not

There are all types of audits, but the bare minimum required by the State of Oregon, the *financial audit*, is one that is based on the review and testing of the city-prepared financial statements and notes to the financial statements with the express purpose of providing users, such as citizens, bond holders, banks and credit agencies, with assurance that the financial statements are free from material misstatement. Information is material if its omission or misstatement could influence the economic decision of users. That's it. An audit does not guarantee that there are no financial problems, challenges, internal control weaknesses, fraud, policy breaches, performance issues, efficiency matters or improvements to processes that need to occur to ensure good stewardship of taxpayer monies. In other words, an audit will not prove that fraud is not present or embezzlement schemes are not occurring; however, as the city of West Linn learned the hard way, when the auditors are disengaged, embezzlers can play.

Know Why Audits are Important

Not only are financial audits required to be in compliance with the state, but financial audits offer a system of necessary checks and balances. Audits help to ensure that material misstatements (or material frauds) are identified

on a timely basis. In addition, independent auditors are experienced and knowledgeable, not only about auditing and municipalities, but about financial disclosure and financial operational processes. Auditors are also hired directly by the audit committee and/or council (or board) and therefore, unbiased and frank communications surrounding financial managers occur.

Know How an Audit Committee Can Help

Elected officials are voted into public office by a majority of voters. These voters expect their officials to represent their interests, and generally, officials are not voted into office because of their financial expertise. Furthermore, local government council (or board) meetings are not conducive to lengthy discussion and explanation, two necessary features for proper oversight of a thorough audit process. This is where a separate audit committee can really serve elected officials well. This committee provides the necessary focus on the internal control issues and provides the oversight that elected officials may not have the ability or resources to perform. They ask the hard financial questions of the independent auditors and keep the finance management in check.

An audit committee should be formally established by the elected officials, have a direct communication line with the auditors and the full council, and should operate without any direct interference from city staff. Certainly, the city manager and finance director provides committee support and coordination, but the role of the audit committee is to provide overall audit oversight.

Best practice suggests that an audit committee for local governments consist of three elected officials. The audit committee is not a citizen committee, like the citizens' budget committee, but instead is an extension of the council (or board), where overall audit responsibility remains with the elected officials. However, much may also be said for including one citizen member who is willing to serve their city in this capacity who possesses municipal accounting and auditing expertise.

Know that the Audit is a Process, not Just a Document

If an audit is simply a document received once a year and filed on a bookshelf, then its numerous advantages are not

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being realized. The audit should be a year-long process with active tasks and goals of an engaged audit committee who embraces the concept of continuous improvement while searching to improve all financial processes. Every finance department has some weaknesses which can be improved upon. The audit committee, with the help of the auditors, serves the public as the committee consistently looking for areas of improvement.

Every audit season should start off with a “kick-off” meeting (around April) with the auditors, end with a “wrap-up” meeting (around December), and have as many meetings in between as there are active issues. Monthly informational updates should be circulated by the finance director to keep the committee engaged throughout the process. Any finance director that is not keeping their audit committee active and engaged is not doing justice for their organization.

Know Your Responsibility to the Community

Elected officials are responsible for financial stewardship of the community’s tax monies. As Harry S. Truman so eloquently stated, “the buck stops here.” If your city does not already have an audit committee, then set one up through a formal motion by the governing body (i.e., resolution, ordinance or charter amendment) and instruct your city manager and finance director to coordinate it and ensure that it stays active and engaged. If your city does not have elected officials with financial expertise, then consider inviting a local citizen with CPA/municipal accounting expertise to serve along with two other council members. Why? Because we are all responsible to ensure the good stewardship of taxpayer’s monies.

Summary

Audits will not detect all embezzlement schemes, they will not find all fraud, they will not prevent an otherwise corrupt finance director’s travel plans, but they help in rooting out the bad apples of public service. Audits will not detect everything because they are not designed to. They are designed solely to provide users assurance that the city-prepared financial statements can be relied upon.

Does your city have an active and engaged audit committee? Are the internal controls understood and documented? Do you know if your finance director has access to prepare and approve journal entries which adjust general ledger account balances? Do you know what happens to your voided check stock? Are you aware of the internal control weaknesses in your financial operations?

Do you know? ■

Editor’s Note: Mr. Seals is the finance director for the city of West Linn and serves as a citizen member on Clackamas County’s Audit Committee. Previously, he was the finance director for the city of Lake Oswego.

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