

A magnifying glass is positioned over a document containing various numbers and currency symbols, such as "\$ 30.66", "237,486", "1,190", "17,000", "4,667", and "1,252,664".

# AUDITS

## Roles & Responsibilities for Elected Officials

### City Audits and the Importance of Oversight

*By Andy Parks*

In the past several years there have been a half dozen embezzlement cases in various government agencies in Oregon, including four in local government totaling more than \$3.7 million. In each case, the discovery of the embezzlement was a complete shock to those who worked with and oversaw these entities.

But should these embezzlements have been “a shock,” or should they have been foreseen given: the increased complexity of reporting and auditing requirements; stagnant or reduced funding for financial operations; tight labor markets for financial professionals; audits often awarded to the lowest bidder; and generally little, if any, interaction between “auditors” and the governing board.

What actions can a governing board take to fulfill their fiduciary responsibility and reduce the likelihood they are not the victim of embezzlement, fraud or other embarrassing financial tragedy? Four key actions include: hire a competent city manager; provide the resources to properly perform the financial functions; hire a capable independent auditor; and provide appropriate oversight. This article will focus on selecting an independent auditor and providing appropriate oversight.

#### **Lack of Oversight Can Cost Cities Dearly**

Around this time each year municipal governments often receive a report from their independent auditors. The report is generally presented at a public meeting and the auditor briefly notes to the council that they have completed their audit and mentions a few highlights. There may be a brief question or two, a motion and second to approve the audit, then a unanimous vote and the audit is off the list of things to do. Too often it all seems so routine. A complicated, backward looking financial report that is read by few and understood by fewer is presented to and approved by councilors in less time than given to the town gadfly’s latest objection to the city’s lighting ordinance.

So why does an issue as important as the city’s actual financial performance generate such little interest? Does the council have tremendous confidence in its finance staff and auditors? Since there may be no significant items mentioned by the auditor, is all assumed to be in good order? Or, do the community’s citizens or its leaders not understand or want to discuss the community’s finances? Whatever the reason(s), the apparent lack of attention and/or interest by governing boards to their city’s financial performance may be worth reconsidering.

As those communities that have experienced embezzlement or a significant financial calamity can attest, the implications to their organizations were far greater than their worst fears. The confidence lost is not limited to the finance staff and/or the auditor, or to the management, but to the governing board as well. The loss in confidence negatively impacts the organization’s ability to address literally every issue it faces. And the lost credibility takes years to restore, and likely new faces.

#### **Oversight as a Principle of the Audit Process**

So what can the governing board and management do to reduce the risk of embezzlement or significant negative financial event(s)? Whether it starts at the bottom of the organization, the top, or somewhere in between, the financial well-being of a city has to be considered an important element to the success of the city. This has to be reinforced through regular communication and discussion of financial matters, between the council and staff and others, such as the independent auditor, as appropriate. And although the reports and ensuing discussion are likely not as interesting or provocative as the latest proposed in-fill development, they must be viewed as no less important to the community.

Oversight will enhance a city’s regular communication and discussion of financial matters. This oversight should come from several sources: internally from department managers, supervisors, and other staff; and externally by the community, the press, lenders, agent of record, elected officials, and independent auditors. Without oversight from all directions, providing checks and balances, a significant deficiency is created thereby increasing the likelihood of a misuse of public funds that could directly attack the credibility of the organization.

## How a Finance Committee Instills Oversight

Faced with limited time and resources, how might a governing board best gain the necessary understanding and provide the appropriate level of oversight? Regulatory agencies and textbooks strongly recommend the use of an “audit committee.” Despite these recommendations, many organizations continue to not have a committee assigned to oversee an auditor or engage with finance professionals. This omission can be addressed fairly simply and the appointment or utilization of a “finance committee” will allow governing boards to have very thorough discussions with their auditor and with staff regarding financial operations and issues.

The use of a finance committee, rather than an “audit committee,” allows the committee to gain a better understanding of a city’s finances and the operation through more frequent meetings (e.g., quarterly), allowing them to communicate with auditors with more confidence and understanding of the financial and auditing issues. An added benefit of this committee is the ability for staff and elected and other key citizens to discuss other financial matters in a very open and collaborative manner.

The “finance committee” can and should include a non-quorum of the governing board with finance expertise or interests and, if desired, one or more interested finance field experts from the community. Additionally, the committee should include the city manager and finance director of the organization. The committee’s responsibilities related to the audit may include selection of auditors, discussion and review of the audit plan, periodic discussion with auditors on audit findings and results, full review of financial statements and management responses to management letter issues and communication to the full board.

## Choosing the Right Auditor

As cities consider the oversight role of the board and individual board members and their independent auditor, it is helpful to gain an understanding of both the audit process and its limitations. To gain this understanding will increase a mayor or councilor’s effectiveness in their roles relative to the city’s financial integrity.

An audit is a critical review of a city’s balances, transactions, process and systems. Auditors use a variety of tactics and techniques to gain a “reasonable level of assurance” that the financial information is accurate. Auditors generally perform the majority of these procedures shortly after the close of the fiscal year (for an annual audit of the financial statements). Annual financial statement audits are required to be completed before December 31 of each year.

It is important to note that a financial statement audit is not designed or expected to detect fraud or embezzlements. But the discovery or prevention of such acts can be enhanced if an audit program gives consideration of potential issues noted by others familiar with the city’s operation and this is known by those being audited. The message sent to those that handle financial activity is that those that are overseeing the finances are more aware and responsive. This action alone provides a disincentive to those that may have inappropriate motives.

For any city, choosing the right auditor is as important as choosing the right engineer for a significant public works project, or the right architect for the design of a public facility, or the right attorney to provide advice on a key public policy matter. None of these professionals are or should be hired by “low bid.” And as is the case with all professional services, it is important to have a very good working relationship with the auditors; for them to know what the city’s expectations are; and if necessary, to advise the city on appropriate expectations. Cities should consider selecting an auditor or audit firm that best demonstrates its capabilities to meet expectations. This may be better accomplished through the use of a Request for Qualification (RFQ) then Request for Proposals (RFP) process.

A council that provides appropriate oversight and selects auditors through a process that is focused on expectations rather than fees will have fulfilled two of the key actions for which it is responsible. These actions will also help to establish or reinforce accountability within the organization, reducing the likelihood of embezzlement or fraud, while enhancing performance. ■

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**Editor’s Note:** *Andy Parks is a principal with the consulting firm GEL Oregon, Inc., who during the past five years has served more than 20 Oregon cities and special districts with a variety of challenging administrative, financial and strategic planning issues. Currently, he is completing an engagement with the city of West Linn to restore its financial position and credibility, while also assisting the cities of Dallas, Troutdale, Prineville and Oregon City.*