

September 17, 2012

The Honorable President and Members
Of the Baltimore City Council
Attn: Karen Randle, Executive Secretary
Room 419, City Hall
100 North Holliday Street
Baltimore, Maryland 21202

Re: City Council Bill 12-0060R – Informational Hearing – Auditing Best Practices

City Council Bill 12-0060R is a City Council Resolution for the purpose of calling on representatives from the Department of Audits to appear before the City Council to discuss how: (1) the Department currently performs its Charter mandated duties, (2) the best practices in municipal and government auditing, and (3) how audits of City agencies can be made more regular, frequent, and effective.

Performance of Charter Mandated Duties

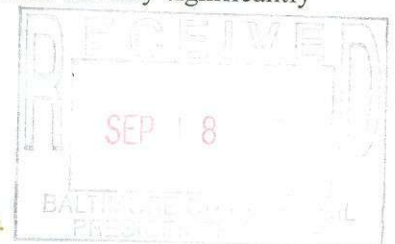
In Article V, Sections 8 and 9 of the Baltimore City Charter, the duties of the Department of Audits are enumerated. These duties include, but are not limited to, the audit of financial transactions of City agencies and the Comprehensive Annual Financial Report (CAFR), which is also described in the Article V, Section 8(a) (2) as the annual audit of all accounts, revenues and receipts of the City. In Article V, Sections 8 (a) (2) and 9 (a), the mandate for the CAFR is prescribed. The City, by Charter is also required in Article V, Section 7(b) to appropriate sufficient funds in the Ordinance of Estimates for the Department of Audits to perform the duties prescribed in the City Charter.

The City of Baltimore is well acquainted with the problems that arise when there are unfunded mandates. Unfortunately, because of the fiscal challenges that the City continues to face, it has not sufficiently funded both the mandate for the audit of the CAFR, which must be performed every year, and the mandate for the audit of the financial transactions of every municipal agency.

As a consequence, the Department of Audits continues to be faced with a conundrum – it is not possible to fully meet both of these mandates. The Department of Audits has accordingly performed its duties in a manner which best protects the interests of the City. The performance of the audit of the CAFR is mission critical for the City. The audit of the CAFR protects the interest of the City and its citizens. If the audit of the CAFR is not performed, the City will endure debilitating consequences, such as:

1. it will not achieve a bond rating that results in the most favorable interest rates,
2. it will not be able to apply for Federal and State grants upon which the City significantly depends upon for the provision of services, and

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3. it will not be able to complete the Single Audit that is required each year by the Federal government. The Single Audit is the audit of all Federal financial assistance received by the City (If the Single Audit is not completed, the City may be subjected to the return of Federal funds and possibly the denial of requests for future federal funds.), which makes up over \$200 Million of the FY 13 budget for the City.

The Department continues to be committed to performing all of its Charter requirements, unfortunately, the Department of Audits has not been sufficiently funded to do so. Therefore, it has not been able to conduct an audit of the financial transactions of every City agency. It is noteworthy, however, to report that although the Department of Audits is not able to perform a financial audit of every City agency, the CAFR, which is prepared by the Department of Finance, does include the financial transactions of every City agency.

Each City agency's or department's financial data is included in the City's financial accounting system. Pursuant to Article V, Sections 8(a) and 9(a), the Department of Audits reviews the CAFR's financial date to ensure that all financial transactions of the City are included in the CAFR. The Department of Audits evaluates the controls over the City's revenues and expenditures.

In performing the audit of the CAFR, the Department of Audits is able, on a City-wide basis, to determine whether the financial transactions of City agencies are consistent with the City's policies and procedures. This high level audit is a testing of expenses, payroll, contracts, revenue, etc. of various City agencies. In order to perform an agency by agency financial audit in addition to the CAFR, additional funding for the Department of Audits is required.

The Department of Audits recognizes the importance of ensuring that City funds are used effectively and efficiently. In furtherance of this principle, the Department of Audits also perform services that assure that agencies use City funds effectively and efficiently in the award of contracts to the private sector for public work or the purchase of goods and services, and grants and agreements with non-profit/community organizations. Through these efforts the Department of Audits has generated actual saving of \$45,313,493.00 from January 1, 1996 through June 30, 2012. The actual savings for the past five years total \$9,607,891. Also, in furtherance of this principle, the Department of Audits has been compelled to use the majority of its budget to assure that the City government will be able to meet the requirements of the bond market and its Federal and State funding; the absence of which will result in severe financial hardship for the City and its citizens. It is not unusual that governmental auditors with mandates similar to those prescribe for the Department of Audits will use the majority of its budget on the CAFR and Single Audit.

The Department of Audits joins this Honorable body in its desire to increase the audits of the financial transactions at the agency level. In order for this to be accomplished there is not only a need for additional audit staff, but the ability of the Department of Finance and agencies to prepare the financial statements that will be audited. A financial audit cannot be performed of an agency that does not have financial statements.

The Department of Audits cannot prepare the financial statements for agencies and then audit those same financial statements. This would impede the independence of the Department of Audits, which is required by the Generally Accepted Government Auditing Standards. In Article VII, Section 11 of the City Charter, the Department of Finance is mandated to perform accounting for the City. Article VII,

Section 11(b) provides, “The Department shall supervise and direct the accounting and bookkeeping of all municipal agencies...” The Department of Audits has a consultative role to the Department of Finance in preparing the required accounts and financial records.

Best Practices in Municipal Audits

The auditing profession, similar to other professions, has certain prescribed procedures and guidance which form the basis of the “best practices” of the profession, whether it is municipal or private. In the performance of municipal audits, the best practices are based upon generally accepted government auditing standards (GAGAS) prescribed by the U.S. Government Accountability Office (Yellow Book). These standards incorporate the American Institute of Certified Public Accountants’ (AICPA) generally accepted auditing standards (GAAS) and the related Statements of Auditing Standards (SAS), and provide the framework for conducting high quality municipal audits with competence, integrity, independence, objectivity and quality. Simply stated, these standards which embody the best practices require:

1. competence – staff assigned must collectively possess adequate professional competence for the required audit tasks.
2. integrity – includes the auditors conducting their work with an attitude that is objective, fact-based, nonpartisan, and non-ideological with regard to the audited entities and users of the audit reports.
3. independence – in all matters relating to the audit work, the audit organization and the individual auditor must be free from personal, external, and organizational impairments to independence, and must avoid the appearance of such impairments of independence.
4. objectivity – includes being independent in fact and appearance, maintaining an attitude of impartiality, having intellectual honesty, and being free of conflicts of interest.
5. quality control - includes the establishment of a system of quality control designed to provide reasonable assurance that the audit organization and its personnel comply with professional standards and applicable legal and regulatory requirements, and have external peer reviews. Some examples of our quality control are the audit plan, the review of all work through the City Auditor and Deputy City Auditor, and the procedures established for audit report preparation and follow-up to ensure corrective actions have been taken.

The City can benefit from both financial and performance audits. Financial audits independently review and assess whether the entity’s financial condition as reported in its financial statements is presented fairly in accordance with recognized criteria. Financial audits also include reports on internal control, compliance with laws and regulations and compliance with provisions in contracts and grants. Performance audits review and assess performance based upon stated requirements or defined business practices. This type of audit provides objective analysis to allow those responsible for governance to use the information to improve performance and operations, reduce costs, and contribute to public accountability.

The Department of Audits is committed to the concept of more financial and performance audits and is planning for the passage of the Charter Amendment (Council Bill 12-0053). However, the Department’s

planning will be ineffective without significant additional resources to provide the staffing necessary to implement the Charter Amendment upon its passage.

Respectfully submitted,



Robert L. McCarty, Jr., CPA
City Auditor

cc: Honorable Joan M. Pratt, Comptroller
Angela C. Gibson, Mayor's Legislative Liaison
Gail F. Adams, Deputy City Auditor
Sheila Wyche