



# ALGA

Association of Local Government Auditors

## Model Legislation Guidelines for Local Government Auditors

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### ALGA's Mission

ALGA is a professional organization committed to supporting and improving local government auditing through advocacy, collaboration, education, and training, while upholding and promoting the highest standards of professional ethics.

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### Introduction

Auditing is a cornerstone of good public sector governance and stewardship. The Association of Local Government Auditors (ALGA) supports the establishment and continuous improvement of independent financial and performance auditing in local government.

Local governments establish, staff, and maintain independent audit functions to enhance accountability, earn and increase citizen confidence and respect for government, and provide an independent and objective perspective. ALGA issued its first edition of *Guidelines and Model Authorizing Legislation for Local Government Audit Functions* in 1992, and issued revisions in 1999, 2007, and 2013.

To establish an audit function in one's own local jurisdiction, we recommend legislation that addresses each of the following key elements

### Independence

When establishing an audit function, it is very important to be explicit in protecting auditors' impartiality and objectivity in conducting their work so decision-makers and the public can rely on audit findings and recommendations. For example, managers of functions that may be audited should not have authority over the work of auditors. In order to be independent in fact and appearance, auditors must be free from conflicts of interest and free from interference in how the work is conducted and reported. Auditors must have systems in place to identify, safeguard against, or report threats to independence. The Government Auditing Standards identify seven types of threats to independence:

- Self-interest threat - the threat that a financial or other interest will inappropriately influence an auditor's judgment or behavior;
- Self-review threat - the threat that an auditor or audit organization that has provided nonaudit services will not appropriately evaluate the results of previous judgments made or services performed as part of the nonaudit services when forming a judgment significant to an audit;
- Bias threat - the threat that an auditor will, as a result of political, ideological, social, or other convictions, take a position that is not objective;
- Familiarity threat - the threat that aspects of a relationship with management or personnel of an audited entity, such as a close or long relationship, or that of an immediate or close family member, will lead an auditor to take a position that is not objective;
- Undue influence threat - the threat that external influences or pressures will impact an auditor's ability to make independent and objective judgments;
- Management participation threat - the threat that results from an auditor's taking on the role of management or otherwise performing management functions on behalf of the entity undergoing an audit; and
- Structural threat - the threat that an audit organization's placement within a government entity, in combination with the structure of the government entity being audited, will impact the audit organization's ability to perform work and report results objectively.

Legislation should be carefully crafted to enhance the independence of the audit function and should be enacted at the highest possible level of authority, such as by voter-enacted amendments to a city charter or other applicable legislation. An employment contract between the auditor and the governing body may also clarify the auditor's responsibilities, terms of employment, and terms of removal.

## Standards

Professional standards provide an overall framework for ensuring that auditors are competent, objective, and independent and act with integrity in planning, conducting and reporting their work. Legislation should require adherence to recognized government auditing standards such as the Government Auditing Standards issued by the Comptroller General of the United States. The International Standards for the Professional Practice of Internal Auditing, issued by the Institute of Internal Auditors, is used by internal auditors in the private sector and in some local governments. Both sets of standards incorporate, by reference, the American Institute of Certified Public Accountants' standards for financial statement audits.

## Independent Audit Committees

Governments must establish protections to ensure that audit functions are empowered to report significant issues to appropriate oversight authorities. One means of accomplishing this protection is through creation of an independent audit committee, selected by the governing body. Audit committees should be independent of management. Members should also be collectively knowledgeable about audits and financial, performance, and governance matters. Inclusion of legislators as well as community members with appropriate qualifications can augment the expertise of the committee, and prevent undue reliance on management. To enhance the independence of the committee, and to enable the auditors to communicate freely, no members of the audit committee should be employees of the entity management. Specific responsibilities of the audit committee vary depending on the form of government, reporting relationship of the auditors, and local preferences

## Other Key Elements of an Effective Audit Function

Additional key elements to consider are:

- **Unrestricted access:** Assure that the auditor has unrestricted access to local government employees, officials, records, vendor contracts and reports.
- **Sufficient funding:** The audit activity must have funding appropriate to the specific responsibilities. Decisions about funding for the auditor should not be under control of management of the entity under audit.
- **Competent leadership and staff:** The chief audit executive should be classified and compensated at a sufficiently senior level to be able to discuss and negotiate with senior management on a reasonably equal footing, i.e., compensated similarly to a department director
- **Public Reporting:** The chief audit executive should have the ability to place items on the legislative agenda for public hearing.
- **Response to Audits:** Require that responsible government managers promptly respond in writing, within a time specified, to audit recommendations explaining what actions are planned or have been taken to deal with problems identified in audit reports.
- **Follow-up:** Require follow-up on significant findings and recommendations from previous audits to determine whether timely and appropriate corrective actions have been taken by management.
- **Contracts:** Ensure that all contracts contain a right-to-audit provision.
- **Coordination:** Assign the auditor responsibility to coordinate and monitor all audits and audit related services received by the local government entity including those performed by public accountants, consultants or audit organizations of the entity and its subdivisions. (In some instances, the auditor does this on behalf of the audit committee)
- **External review:** Provide for periodic peer reviews of the audit function.

## Existing Legislation

The guidelines provided are meant to be considered in establishing legislation that will make sense for your own particular community. It is important to be aware of existing laws, which may be in conflict with the proposed legislation, and to address any conflicts with the help of attorneys and specialists, before bringing legislation forward for a vote by the governing body or the citizens. In some cases, it may be necessary to amend laws at a higher level of government. For example, many states and provinces have open meeting and public records laws that encourage transparency or disclosure of government operations. Therefore, audit reports are released to the public. Yet, with regard to allegations of fraud, waste and abuse, jurisdictions may have adopted laws limiting disclosure of information until an investigation is complete. It may also be necessary to amend open meetings laws in order for the audit committee to fulfill its responsibilities.

## SAMPLE ENABLING LEGISLATION: CHARTER OR CODE

The Charter or Code to establish an audit function is an important document. It sets forth the qualifications, duties, powers and manner of securing the office of the local government Auditor. The local governing body will enact legislation in various forms, depending on the particular state or provincial constitution or statutes. The information contained in this document is to be considered as general guidelines to be adapted in context with applicable state or provincial laws. Elements described on the following pages are applicable to a legislatively appointed or elected Auditor and, with some modifications to a management-appointed Auditor.

### Ordinance/Resolution/Policy Statement

WHEREAS, public officials, government managers, and private citizens want and need to know not only whether government funds are handled properly and in compliance with laws and regulations, but also whether public programs are achieving the purposes for which they were authorized and funded, and, whether they are doing so efficiently, effectively, and equitably;

WHEREAS, an independent auditing function can provide objective information on the operations of government programs, assist managers in carrying out their responsibilities, and help ensure full accountability to the public;

WHEREAS, recognized government auditing standards provide a framework for improved government decision-making, oversight and accountability;

WHEREAS, the independence and public accountability of the Auditor can be assured by provision of an (elected or legislatively appointed) Auditor;

NOW BE IT RESOLVED;

#### **Organizational Independence – Establishment of the Audit Function**

(Elected or Appointed) The (NAME OF OFFICE/DEPARTMENT) is hereby established.

(Appointed Auditor) The (CITY/COUNTY) Auditor shall be designated through appointment by a majority vote of the (LEGISLATIVE BODY).

#### **Term**

(Elected Auditor) The term of the Auditor shall be \_\_\_\_\_ years.

(Appointed Auditor) The Auditor shall serve a minimum term of \_\_\_\_\_ years, unless removed for cause by a vote of at least two-thirds of the legislative body. The Auditor may be reappointed at the end of the term of office.

#### **Nonpartisanship**

The position of the Auditor shall be nonpartisan.

#### **Restrictions on Other Candidacy**

Filing for an elective office over which the Auditor has audit jurisdiction will be the same as resignation, effective as of the date of filing.

#### **Qualifications - Competent Leadership**

The Auditor shall possess adequate professional proficiency for the job, demonstrated by relevant certifications such as Certified Internal Auditor (CIA), Certified Public Accountant (CPA) or Chartered Accountant (CA) or have an advanced degree and at least five (5) years of experience in government auditing, evaluation or analysis. The Auditor should have a bachelor's degree in public policy, accounting, business administration, economics or a related field. (note: for elected auditors, qualification will have to be more specific. Some U.S. cities require obtaining either the CPA or the CIA designation, while a few require only that the individual be registered to vote in the entity.)

## **Compensation**

The Auditor shall be compensated at a level consistent with the jurisdiction's department directors. Experience, performance, certifications and advanced degrees may be taken into account in determining compensation.

(Elected or Appointed) Auditor may include: The (CITY/COUNTY) Auditor's salary shall be set by the legislative body and reviewed annually. (In some jurisdictions, specific guidelines for the Auditor's salary and budget are established in the Charter or Code. Salary guidelines for elected auditors sometimes are tied to salaries of judges or other auditors)

## **Funding**

Sufficient funds shall be proposed and approved to carry out the responsibilities specified herein. The Auditor's budget shall be submitted to Council directly by the Auditor or by the Audit Committee. (Note: more specific language in some entities requires that the audit function receive a specific percentage of the annual budget or exempts the function from management proposed across the board budget reductions).

## **Appointment of Employees**

The Auditor shall have the power to appoint, employ, and remove such assistants, employees and personnel as deemed necessary for the efficient and effective administration of the affairs of the office and to prescribe their duties, scope of authority and qualifications.

## **Professional Development**

Sufficient resources shall be made available to the Auditor and staff to ensure appropriate professional development, continuing professional education and compliance with applicable certification requirements.

## **Powers and Duties: Scope of Audits**

The Auditor shall have authority to conduct financial and performance audits of all departments, offices, boards, activities, agencies and programs of the entity in order to independently and objectively determine whether:

1. Activities and programs being implemented have been authorized by government Charter or Code, state or provincial law or applicable federal law or regulations and are being conducted and funds expended in compliance with applicable laws;
2. The department, office, or agency is acquiring, managing, protecting, and using its resources, including public funds, personnel, property, equipment, and space, economically, efficiently, equitably, and effectively and in a manner consistent with the objectives intended by the authorizing entity or enabling legislation;
3. The entity, programs, activities, functions, or policies are effective, including the identification of any causes of inefficiencies or uneconomical practices;
4. The desired result or benefits are being achieved;
5. Financial and other reports are being provided that disclose fairly, accurately, and fully all information required by law, to ascertain the nature and scope of programs and activities, and to establish a proper basis for evaluating the programs and activities including the collection of, accounting for, and depositing of, revenues and other resources;
6. Management has established adequate operating and administrative procedures and practices, systems or accounting internal control systems and internal management controls; and
7. Indications of fraud, abuse or illegal acts are valid and need further investigation.

## **Standards**

Audits shall be conducted in accordance with recognized government auditing standards.

## **Audit Committee**

**Note:** An audit committee may be established in an advisory capacity to provide recommendations on such issues as the Auditor's salary, work program, review of the audit function and hiring and oversight of external auditors. An elected Auditor may consider establishing an audit committee to ensure that audit issues receive appropriate attention and resources from the governing body, and to safeguard against challenges to independence from management. The following describes a possible audit committee structure when the Auditor is appointed by the legislative branch or by the independent audit committee itself. This structure, with minor modifications, would also serve to enhance the independence of a management-appointed Auditor or, with additional modifications, an elected Auditor.

1. To ensure independence of the audit function, an audit committee is hereby established. The audit committee shall consist of \_\_\_\_\_ voting members; \_\_\_\_\_ (Council or Board Members) and \_\_\_\_\_ at-large members, who shall be appointed by

the legislative body. The \_\_\_\_\_ at-large members shall be residents of the (CITY/COUNTY) with expertise in auditing, preferably performance auditing as well as financial auditing. Minimum professional standards shall include at least five years of experience as a performance auditor, a Certified Public Accountant, Certified Internal Auditor, Certified Management Accountant or ten years of other relevant professional experience. Of the \_\_\_\_\_ at-large members, one member shall be appointed for a term expiring on January 31, 20xx; one member shall be appointed for a term expiring on January 31 of the following year; and one member shall be appointed for a term expiring on January 31 of the subsequent year. Thereafter, members shall be appointed for three-year terms. The \_\_\_\_\_ at-large members are limited to two full consecutive terms, with one year intervening before they become eligible for reappointment.

2. The audit committee shall consult with the (CITY/COUNTY) Auditor regarding technical issues and work to assure maximum coordination between work of the Auditor's office and external audit efforts.
3. The audit committee shall meet as needed to perform its duties but shall not meet less than once quarterly and shall be responsible for:
  - Reviewing the Auditor's audit plan annually and submitting a proposed Auditor's Office budget annually to the (CITY COUNCIL/COUNTY BOARD) (note: or to the Auditor for submission to the legislative body);
  - Performing regular evaluations of the (CITY/COUNTY) audit function (if not elected) and making recommendations for the chief audit executive's salary and staffing; reporting results to the (CITY COUNCIL/COUNTY BOARD);
  - Providing suggestions and comments for the annual audit plan;
  - Ensuring that audit reports are transmitted to the legislative body and to the public;
  - Monitoring follow-up on reported findings to assure corrective action is taken by management;
  - Reporting to the legislative body on problems or problem areas at such times as deemed appropriate;
  - Conducting or overseeing the requests for proposal and selection process for the firm conducting the annual financial statement audits; ranking and recommending in order of preference no fewer than three firms deemed to be the most highly qualified to perform the required services. If fewer than three firms respond to the RFP, the committee shall recommend such firms as it deems to be the most highly qualified. (note: alternatively, the Auditor may conduct the RFP process and the audit committee may select the firm);
  - Evaluating the firm providing annual financial statement auditing services and providing oversight of those services, including ensuring transmission of reports and follow up on corrective action by management;
  - Evaluating the findings and recommendations of the peer review as required by recognized government auditing standards;
  - Consulting with the (CITY/COUNTY) Auditor regarding technical issues with the external audit firm, and working to assure maximum coordination between work of the Auditor's Office and contracted audit efforts and other consulting engagements;
  - Maintaining the confidentiality of personnel matters while taking responsibility for appropriate disclosure to the legislature or to the public;
  - At least annually, meeting separately with the (CITY/COUNTY) Manager, (CITY/COUNTY) Auditor, the chief financial officer, and the audit firm, to evaluate the condition of the entity's controls, systems and risk, and performance of the audit firm, and to discuss other matters the firm, the auditors, or staff desires or is required to bring to the committee's attention such as fraud, illegal acts, and financial and control weaknesses.
4. The audit committee shall have the authority to hire outside experts, including legal counsel, when necessary
5. Sufficient resources shall be provided to enable the audit committee to carry out these responsibilities.

### **Audit Schedule**

At the beginning of each calendar/fiscal year, the Auditor shall submit a one-to-five-year audit schedule to the legislative body or audit committee for review and comment. The schedule shall include the proposed plan, and the rationale for the selections, for auditing departments, offices, boards, activities, subcontractors and agencies for the period. This schedule may be amended after review with the legislative body or audit committee, but the Auditor shall have final authority to select the audits planned.

In the selection of audit areas and audit objectives, the determination of audit scope and the timing of audit work, the Auditor should consult with federal and state or provincial auditors and external auditors so that the desirable audit coverage is provided and audit effort is properly coordinated.

### **Access to Employees, Records and Property**

All officers and employees of (NAME OF ENTITY) shall furnish to the Auditor unrestricted access to employees, information and records (including electronic data) within their custody regarding powers, duties, activities, organization, property, financial transactions, contracts and methods of business required to conduct an audit or otherwise perform audit duties. In addition, they shall provide access for the Auditor to inspect all property, equipment and facilities within their custody. If such officers or employees fail to produce the aforementioned access and/or information, the Auditor may initiate a search to be made and

exhibits to be taken from any book, paper or record of any such official or employee, or outside contractor or subcontractor, except as governed by statute. Further, all contracts with outside contractors and subcontractors shall contain a "right-to-audit" clause and provide for Auditor access to the contractor's employees and to all financial and performance related records, property, and equipment purchased in whole or in part with governmental funds.(note: some jurisdictions specify subpoena powers for the Auditor)

### **Agency Response**

A final draft of the audit report will be forwarded to the audited agency and the chief executive officer for review and comment regarding factual content prior to its release. The agency must respond in writing, specifying (i) agreement with audit findings and recommendations or reasons for disagreement with findings and/or recommendations; (ii) plans for implementing solutions to issues identified; (iii) a timetable to complete such activities. The response must be forwarded to the Auditor within (SPECIFY TIME FRAME). The Auditor will review and report on information included in the agency's response. If no response is received, the Auditor will note that fact in the transmittal letter and will release the audit report.

### **Audit Reports**

Each audit will result in a report, written or in some other retrievable form. The report shall contain relevant background information and findings and recommendations, and shall communicate results to the audit committee, legislative body management and the public.

### **Report of Irregularities**

If, during an audit, the Auditor becomes aware of abuse or illegal acts or indications of such acts that could affect the governmental entity, the Auditor shall report the irregularities to the audit committee, the chief executive officer, legislative counsel or legislative body. In the case of an Auditor appointed by the chief executive officer, if the chief executive officer is believed to be a party to abuse or illegal acts, the Auditor shall report the acts directly to the legislative body. If it appears that the irregularity is criminal in nature, the Auditor shall notify the chief prosecuting authority in addition to those officials previously cited.

### **Annual Report**

The Auditor shall submit an annual report to the legislative body indicating audits completed, major findings, corrective actions taken by administrative managers, and significant issues which have not been fully addressed by management.

### **Audit Follow-up**

The Auditor shall follow-up on audit recommendations as practical to determine if corrective action has been taken. The Auditor may request periodic status reports from audited agencies regarding actions taken to address reported deficiencies and audit recommendations.

### **Contract Auditors, Consultants and Experts**

The Auditor may obtain the services of Certified Public Accountants, qualified management consultants, or other professional experts necessary to perform audit work. An audit that is performed by contract must be conducted by persons who have no financial interests in the affairs of the governmental entity or its officers. The Auditor will coordinate and monitor auditing performed by certified public accounting firms or other organizations employed under contract by the (NAME OF ENTITY) to assist with audit related activities. Contracting for the external audit will follow (NAME OF ENTITY)'s normal contracting processes except for the participation and oversight by the Audit Committee (and/or Auditor). The selection of a certified public accounting firm for the annual financial audit must be approved by (LEGISLATIVE BODY).

### **Peer Reviews**

The audit activities of the Auditor's office shall be subject to a peer review in accordance with applicable government auditing standards by a professional, nonpartisan objective group utilizing guidelines endorsed by the Association of Local Government Auditors (ALGA). A copy of the written report of this independent review shall be furnished to each member of the (LEGISLATIVE BODY).

The peer review will use applicable government auditing standards to evaluate the quality of audit effort and reporting. Specific quality review areas shall include staff qualifications, adequacy of planning and supervision, sufficiency of work paper preparation and evidence, and the adequacy of systems for reviewing internal controls, fraud and abuse, program compliance, and automated systems. The peer review will also assess the content, presentation, form, timelines, and distribution of audit reports. The (NAME OF ENTITY) shall pay for the costs of the peer review from the Auditor's budget.