



County Executive Office

Larry Parrish
County Executive Officer

July 7, 2004

Honorable Board of Supervisors
County of Riverside
Robert T. Andersen Administrative Center
4080 Lemon Street, 4th Floor
Riverside, CA 92501-3651

SUBJECT: Recommendation on Board Appointments to Audit Committee

Board Members:

On June 29, 2004, this Board referred to the Executive Office for study and recommendations the Auditor-Controller's request to appoint members of the Board to an audit committee (Item No. 3.45). This report responds to the Board's direction on that issue.

The Auditor-Controller cites as key reasons for proposing an audit committee providing a link between operating departments and the external auditors, and ensuring the independence and effectiveness of the internal auditing function, in addition to assuring that appropriate consideration is given to audit findings and recommendations. There is increasing interest in establishing audit committees, particularly in the private sector, where the independence of external auditors is called into question with increasing frequency in the wake of corporate scandals.

This interest is mirrored by the Government Finance Officer's Association (GFOA), which published a revised recommendation on this subject in 2002. In their October 25, 2002, opinion "Establishment of Audit Committees" (see attached), the Executive Board of the GFAO notes, among other things, that:

The auditor of a state or local government's financial statements must be independent, both in fact and in appearance. A properly constituted audit committee helps to enhance the financial statement auditor's real and

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perceived independence by providing a direct link between the auditor and the governing board.

This is a broad policy statement intended to blanket a large country with diverse regional governmental structures and practices. What must also be considered is California state law anticipates these concerns. The Government Code provides for election of the office of county auditor specifically to ensure such independence and direct accountability to the citizens. The law further requires the county auditor to file copies of the county's independently audited financial statements and its internal audit reports with the county board of supervisors for the specific purpose of providing that direct link to the county's governing board and the public.

In these ways, the law already provides protections to ensure that management cannot wield undue influence over the audit process, nor suppress or influence audit findings. Furthermore, as an elected official, the county auditor has standing to communicate directly with the elected members of the county board of supervisors and with the public at large.

The Board requested the Executive Office explore what other counties are doing with respect to audit committees. In the time available, it was possible to poll twelve county auditor's offices. Of these twelve, all had elected auditors, and three had audit committees. Two reported that they have had audit committees for some time. One has just newly established an audit committee in response to a Grand Jury report. The other nine counties polled did not have audit committees. In most cases, where a position on the subject could be ascertained, they indicated the independence of the elected office served the same purpose.

If the Auditor-Controller wishes to call a committee of his own to address issues of prioritization, implementation, procurement of services, etc., it is certainly his prerogative to do so under his own authority. If he wishes to engage the Board of Supervisors or Executive Office on issues of concern, he has existing channels available to him. My analysis is that the objective of assuring the independence and transparency of the external auditors and internal audits is already achieved through the independently elected office of county auditor, and therefore no further action on the part of the Board to participate in an audit committee is necessary.

Respectfully submitted,


LARRY PARRISH
County Executive Officer

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COUNTY OF SAN DIEGO
CLERK OF SUPERVISORS

Establishment of Audit Committees (1997 and 2002)

Background. The auditor of a state or local government's financial statements must be independent, both in fact and in appearance. A properly constituted audit committee helps to enhance the financial statement auditor's real and perceived independence by providing a direct link between the auditor and the governing board.

One important advantage of an audit committee is that it helps to facilitate communication between management, the auditors, and the governing board. An audit committee also limits the reliance governing bodies must place on the technical expertise of the independent auditor. An audit committee is useful, too, in helping to focus and document the government's process for managing the financial statement audit.

In recent years, the importance of audit committees has come to be recognized increasingly in both the public and private sectors. This importance is reflected in the requirement set by generally accepted auditing standards that auditors determine that the audit committee (or its equivalent) is informed of various matters of importance related to the financial statement audit. The audit committee should play an advisory role to the governing body. Management and the governing board remain ultimately responsible for the fair presentation of the financial statements and for obtaining and monitoring the financial statement audit.

Recommendation. The Government Finance Officers Association (GFOA) makes the following recommendations regarding the establishment of audit committees by state and local governments:

- Every government should establish an audit committee or its equivalent. Reliable audits are essential to the credibility of financial reporting by state and local governments. The audit committee is a practical tool that a government can use to enhance the independence of the external auditor, and hence the reliability of the financial statement audit.
- The audit committee should be formally established by charter, enabling resolution, or other appropriate legal means.
- The members of the audit committee collectively should possess the expertise and experience in accounting, auditing, financial reporting, and finance needed to understand and resolve issues raised by the independent audit of the financial statements. When necessary or otherwise desirable, members of the audit committee should be selected from outside the government to provide the needed expertise and experience.
- A majority of the members of the audit committee should be selected from outside of management. At the same time, the audit committee should include at least one representative each from the executive and legislative branches of the government.

- An audit committee should be sufficiently large to ensure that its members possess all of the skills needed to realize the committee's objectives. At the same time, the audit committee should be small enough to operate efficiently. Therefore, as a general rule, an audit committee should be composed of no less than five and no more than seven members.
- Members of the audit committee should be educated regarding both the role of the audit committee and their personal responsibility as members, including their duty to exercise an appropriate degree of professional skepticism.
- The primary responsibility of the audit committee should be to oversee the independent audit of the government's financial statements, from the selection of the independent auditor to the resolution of audit findings.
- The audit committee should have access to the reports of any internal auditors, as well as access to any annual internal audit work plans.
- The audit committee should present annually to the governing board and management a written report of how it has discharged its duties and met its responsibilities. It is further recommended that this report be made public.

References

- *Audit Management Handbook*, Stephen J. Gauthier, GFOA, 1989.
- Model Audit RFP Diskette, GFOA.

Approved by the Committee on Accounting, Auditing and Financial Reporting
June 15, 2002

Approved by the Executive Board, October 25, 2002