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Chairman Towns, Ranking Minority Member Issa, and Members of the Committee:

My name is Jerome Heer, Director of Audits for Milwaukee County, Wisconsin. I am a founding member of the Association of Local Government Auditors (ALGA) and served as president of the organization in 1994 and 1995. I've served on the U.S. Government Accountability Office's (GAO) Domestic Working Group since 2001, and as a member of the Comptroller General's Advisory Council on Government Auditing Standards since 2004.

I'm honored to be here today to speak to you on behalf of ALGA to give you a broad overview of local government efforts to ensure transparency and accountability for the use of federal stimulus funds disbursed under the American Recovery and Reinvestment Act (Recovery Act). I'll discuss steps local officials are taking to prevent and detect wasteful spending, plans for audits and investigations to identify fraud in stimulus programs, and oversight challenges specific to local governments.

The good news is that much of the necessary oversight infrastructure is already in place. Local governments that have independent auditors provide greater assurance that federal funds are used appropriately to achieve intended benefits. ALGA members see how federal dollars support specific programs or projects, and we craft our audit plans to focus accountability on areas needing improvement. In addition, we communicate regularly with our state and federal counterparts on potential audit areas.

Local government audit organizations are conducting required audits of federal grants, performance audits of programs expected to be eligible for funding, and recurring audits of internal control systems that form the backbone of accurate and transparent reporting. Local government audit organizations are also operating hotlines to flag potential waste and abuse. Unfortunately, local governments face significant challenges. Many local governments lack an independent audit function. Among the local governments that do have independent audit function, the majority are very small in comparison to the areas subject to audit. Finally, most local government audit organizations, like the jurisdictions they serve, have experienced budget reductions in the current economic downturn.

First, I'd like to say a little bit about our organization. ALGA was founded in 1989 to support and strengthen local government auditing through advocacy, collaboration, education, and training, while upholding the highest standards of professional ethics. ALGA provides training, networking and information-sharing opportunities for members through conferences, seminars, a quarterly newsletter, and a robust listserv. ALGA promotes the value of independent performance auditing throughout the local government community. ALGA provides model legislation and guidance to assist local governments in establishing independent audit functions and offers professional resources and support to organizations with new audit functions and organizations considering diminishing their audit function. ALGA also provides a peer review program to assure local officials and the public that the auditors maintain competence, integrity, objectivity, and independence in planning, conducting, and reporting their work.

ALGA currently comprises about 300 organizational members, representing more than 2,000 auditors in cities, counties, school districts, transit authorities, and local utilities. Nearly 60% of our member organizations are in the 16 states that the GAO has selected for ongoing longitudinal analysis of use of the Recovery Act funds. The GAO has estimated that these states – Arizona, California, Colorado, Florida, Georgia, Iowa, Illinois, Massachusetts, Michigan, Mississippi, New Jersey, New York, North Carolina, Ohio, Pennsylvania, and Texas – will receive about two-thirds of the intergovernmental grant funds available through the Recovery Act.

ALGA is well positioned to coordinate with the GAO in its mandate to monitor local use of the funds. Local government auditors possess deep knowledge about their organizations' procurement and operational processes, as well as financial recording and reporting. ALGA sponsored a teleconference with Acting Comptroller General, Gene Dodaro, to discuss how the Recovery Act will affect local government audit organizations and ways to coordinate audit and oversight efforts. We have also invited GAO to speak at our annual conference in May for a more in-depth discussion of audit approaches and the role local government auditors will play in assuring transparency and accountability for use of Recovery Act funds.

What proactive steps are local officials taking to prevent wasteful spending? While we are still learning about the requirements of the Recovery Act, some of our member organizations have already taken steps to alert managers of monitoring requirements and management principles defined in the act. In addition, some member organizations are providing fraud prevention training, with special emphasis on federal requirements. Some organizations are creating central positions to oversee administration of federally funded projects. Some audit organizations are establishing ways to identify and track inflows of stimulus funds, a task that may be complicated because the funds will be allocated through various federal and state agencies.

In addition, existing oversight infrastructure will help provide assurance that Recovery Act funds are well spent and the process is transparent, including:

- **Single Audit.** Federal law requires a standardized audit or examination to provide assurance that recipients' use of federal assistance funds complied with applicable laws and grant provisions. The requirement applies to state and local

governments and nonprofits receiving \$500,000 or more of such assistance in a year. The audit encompasses financial records, statements, transactions and expenditures; general management of operations; and systems of internal control. The auditor is required to report to the federal government instances of noncompliance, deficient internal controls, illegal acts, fraud, and questioned costs. Questioned costs – spending that the auditor determined was not permitted – must be returned to the federal government. Results of the audits are summarized on a standard data collection form and submitted to the federal granting agencies.

Due to the size and scope of the Recovery Act, we anticipate that much of the newly available federal assistance will be subject to Single Audit requirements. Many of our member organizations either assist the external auditors in conducting the Single Audit or are responsible for contracting for the audit.

- **Performance audits.** Unlike the Single Audit, performance audits most often seek to assess whether a program is achieving the intended benefits at a reasonable cost. Performance audits are intended to make recommendations to improve operations, rather than simply to correct deficiencies, although the scope and objectives of performance audits vary and can include assessing compliance with applicable laws and regulations. Performance audits provide a more in-depth perspective on whether funds are well spent, but are not standard across jurisdictions and are resource-intensive. More than 80% of our member organizations conduct performance audits, which account for an average of about 60% of their audit time.
- **Cyclical audits.** About two-thirds of our member organizations conduct financial-related audits of payroll, accounts payable, or information systems on a regular cycle to test their government's disbursements and related internal controls. Audit procedures include tests intended to identify indicators of potential fraudulent, wasteful, or abusive activity.
- **Hotlines.** Many local government audit organizations operate hotlines to receive information from employees, vendors, and members of the public regarding waste, fraud, and abuse. These audit organizations have established policies and procedures for recording, tracking and reporting on hotline activity, protocols for investigating complaints, and ultimately for referring cases for prosecution or other disciplinary action. Several states have passed Whistleblower protection legislation that exempt hotline records from being subject to open records requests to protect the confidentiality of those who report observed or suspected wrongdoing.
- **Continuous monitoring.** Some local government audit organizations have undertaken continuous monitoring, which uses information technology data

extraction tools to flag unusual financial transactions, either in real time or on a periodic basis. The existence of red flags can trigger an audit or investigation.

- **Public reporting.** Local government auditors issue public reports on their findings, including activities related to projects with federal assistance. In addition, audit results are often presented at meetings that are televised or posted as videos on government web sites. These public discussions provide transparency in how the organizations use federal funds and provide forums for public input.
- **Financial impact statements on legislation.** Some local governments require financial impact statements to accompany proposed legislation or agenda items that identify the sources of funds and expected longer-term impacts. These documents also provide transparency in how the organization intends to use federal funds and the expected benefits. While more common at the state level, some local government audit organizations are responsible for preparing or reviewing the financial impact statements.
- **Coordination with auditors at different levels of government.** Local government auditors communicate and interact with federal and state auditors through the National Intergovernmental Audit Forum and its 11 regional branches. The forum is an association of audit executives at all levels of government with a mission to improve coordination, cooperation, and communication among its members; to address common challenges; enhance government performance, accountability, and transparency; and increase public trust.

GAO plans to leverage existing resources as part of its oversight of state and local spending under the Recovery Act. ALGA will continue to coordinate and liaise with the GAO and federal Inspectors General as Recovery Act assistance is awarded and projects get underway.

What plans have local government auditors made for audits and investigations to identify and prosecute fraud in stimulus programs? Most of our member organizations have not yet scheduled specific audits of programs funded by the Recovery Act because we are still learning how our governments will use the funds. However, much of the funding appears to be allocated to increase spending on, or reduce cuts to, existing programs such as airport security, roads and bridges, and local law enforcement. We anticipate that many of these high-profile programs are already part of existing audit plans. Additionally, most of our member organizations prepare risk-based audit plans.

Because federally funded projects carry inherent compliance risks, we anticipate that local government audit organizations will add audits of these projects to their upcoming annual plans. Most importantly, the large majority of ALGA members follow the same audit standards as the GAO, which require us to notify law enforcement when we uncover evidence of potential fraud.

What challenges do local governments face in meeting their oversight obligations? We recognize the potential benefits that stimulus funds will have on our jurisdictions and our local economies. The additional funds, however, carry additional responsibilities. Local governments face significant challenges in meeting their oversight obligations.

- **Lack of independent audit functions in many jurisdictions.** Despite ALGA's ongoing advocacy efforts, we estimate that fewer than 20% of the nation's larger cities and counties have an independent audit function.

While there are no authoritative figures, we estimate that only about 42% of the approximately 1,500 U.S. cities and counties with populations greater than 50,000 have an audit function. Jurisdictions without an in-house audit function hire commercial audit firms to conduct financial and applicable single audits, and may hire audit firms or consultants to review operations. While commercial firms provide a valuable service, they are less familiar with internal operations and less committed to long-term organizational improvements than in-house auditors who can provide continuity in oversight and long-term follow-up on recommendations.

Further, we estimate that only about 45% of local government audit organizations meet the definition of independence in the Comptroller General's *Government Auditing Standards*. Many local government auditors have reporting relationships within their organizations to those responsible for areas subject to audit, and lack sufficient statutory protections against interference in how they conduct their work or report results. Many local government auditors also face restricted access to employees, property, records, and information systems.

If I could offer one suggestion to improve accountability nationwide, my request would be future federal legislation crafted in a way that encourages more local jurisdictions to create audit functions that follow *Government Auditing Standards*. Ultimately, every taxpayer would benefit from stronger oversight and improved effectiveness when federal dollars are spent at the local level. ALGA members across the country are prepared to advise and assist those jurisdictions in building an effective accountability system.

- **Limited audit resources.** The majority of local government audit organizations are very small in comparison to the areas subject to audit. One-third of our member organizations have only one or two staff, and another 30% have three to five staff. Only 8% of our member organizations have more than 15 auditors on staff. While our member organizations are carrying out important, innovative work, they do not currently have the ability to take on additional tasks. We will need to realign our work priorities to meet the needs of the Recovery Act.
- **Economic downturn.** Finally, most local government audit organizations, like the jurisdictions they serve, have experienced budget reductions in the current economic downturn. Many of our member organizations have cut positions,

implemented furloughs, and reduced training and travel budgets. Some of our member organizations have been eliminated as their jurisdictions work to balance budgets. In fact, our membership has declined by nearly 5% from last year.

Despite these challenges, we are pleased that the GAO has recognized the value that local government auditors provide to the accountability community, to their jurisdictions, and to the public in enhancing transparency and accountability for the use of public resources. We welcome the opportunity to work closely with the GAO and other federal agencies to provide the same rigor to oversight of local governments' use of the federal stimulus funds.