

BEST

Practices



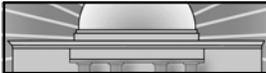
Volume 2, Issue 1

Spring 2005

INSIDE



Public Sector Audit Committees		2
• Composition of the Audit Committee		2
• Committee Meetings		3
• Committee Functions		4
• Establishing the Committee		5
• Sample Documentation for Audit Committees		5



Public Records		7
• An Office's Responsibilities		7
• Liabilities		7
• Costs that May be Assessed		7
• Common Problems and Suggested Remedies		8
• Public Records Request Response Policies		9



An Update on Identity Theft		10
• The AOS Takes Action Against Identity Theft		10



A Message from Auditor of State Betty Montgomery

Dear Colleague,

My office is happy to present the latest edition of *The Ohio Auditor of State's Best Practices* publication. We are pleased that we continue to receive positive feedback from local officials across the state.

Our state continues to face challenging economic times. Leaders at the state level are looking for innovative ways to lessen the burden on local governments as well as taxpayers. I think we'll find this budget cycle to be as difficult as any we've seen.

To that end, we continuously look for ways to help local officials provide the best possible services to their citizens within the bounds of available resources.

In this edition of *Best Practices* we highlight the **public sector audit committee**. Audit committees are intended to provide insight and expertise to the technical and complex issue of government accounting. They can also provide essential oversight over the implementation of audit recommendations. This edition also reviews issues of public records, including a discussion on public record response policies. Finally, we will discuss identity theft and ways in which your government can help safeguard personal taxpayer information.

As before, we provide you with a number of model policies. And as always, we encourage your feedback. We hope *Best Practices* provides practical information that will help you serve the citizens of Ohio.

Sincerely,

Betty Montgomery
Ohio Auditor of State

Public Sector Audit Committees

Audit-speak: “Our GAAS report agreed that your GAAP statements are fairly stated, but our GAGAS report listed several material weaknesses.”

Some say men and women come from different planets, but auditors can sometimes seem to be from another galaxy altogether. To provide a professional link and sounding board between management and auditors, businesses — and more recently, governments — establish audit committees. These committees can help management and governing authorities not only understand unfamiliar audit terminology and concepts, but they can also help ensure audit recommendations are sufficiently addressed. Furthermore, according to the Government Finance Officers Association (GFOA), audit committees enhance the independence of the external auditor, thus increasing the reliability of the government’s financial statement audit.



In fact, the Auditor of State’s Office (AOS) has recommended establishing such committees for many years now. Generally, the AOS provides some variation of the following recommendation in client audit reports:

We recommend District X establish an audit committee to perform the following functions:

- *Review the annual unaudited financial report submitted to the AOS;*
- *Periodically review the process used to prepare interim financial information submitted to District X’s governing board;*
- *Review audit results;*
- *Assure that audit recommendations are appropriately addressed; and*
- *Serve as liaison between management and independent auditors.*

Although this committee could include officials from District X, it is preferable that the committee include representation that is independent from elected officials and management. The audit committee should meet regularly (perhaps quarterly) to monitor District X’s financial reporting and control activities. The committee should also meet with District X’s independent auditors before and after each audit.

Composition of the Audit Committee

Considering the unique nature of how governments operate compared to businesses, the AOS recommends that public sector audit committees be composed of persons generally independent of the government’s governing board and management group. In the private sector, committee members are often chosen from among a business’ Board of Directors. These individuals are typically independent of the business’ management group. Thus, they are naturally positioned to provide an independent, objective perspective on the business’ auditing activities. Given that the management group in government, however, might also be elected officials (e.g., mayors, city auditors, county commissioners, county auditors, boards of township trustees), the AOS recommends that the audit committee have at least some representation from outside the government. Moreover, these repre-

sentatives should have some level of expertise in governmental accounting and auditing so they can make informed decisions and effectively serve the committee.

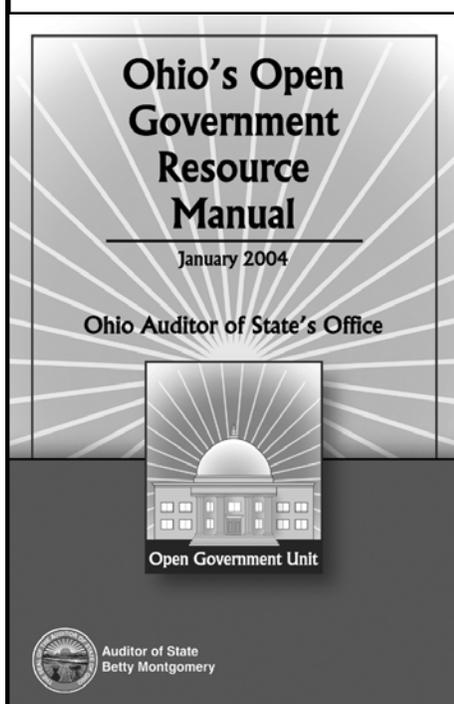
Audit committees, at minimum, usually include three members; at maximum, they usually include seven members. As a rule of thumb, the size of the audit committee should be commensurate with the size and complexity of the government. The following descriptions of audit committees from around Ohio exemplify the variety that exists in terms of size and mix of committee membership:

- The **Columbus Public Schools Audit Committee** consists of five members: three from the Board of Education and two from the community, appointed by the Board. One of the two community members is a business person; the other a partner with a CPA firm with expertise in the governmental sector.
- **Cleveland MetroParks**, which has an appointed board and management, has a three-person audit committee composed entirely of individuals from outside the agency. These three members are all either current or former partners of CPA firms in the Cleveland area.
- **Ross County** has an interesting arrangement with the townships located in the county. Such townships' audit committees consist of three members, the Clerk Treasurer of the Township, the Ross County Auditor, and the Deputy Ross County Auditor.

Because of the unique nature of county government, with its multiple elected officials, the AOS started recommending in 1997 that counties set up a "Fiscal Report Review Committee," consisting of the County Auditor, County Treasurer, and President of the Board of County Commissioners [or their designees]. Many counties in Ohio have established such committees.

Committee Meetings

Typically, audit committees meet up to four times a year. The committee should meet at least twice during the audit process itself: once, before the auditors have begun the audit in order to review audit plans and communicate any special areas of concern or focus, and once, near the end of the audit, to review the draft audit report.



Whether these meetings are subject to Ohio's Open Meetings Act (OMA), commonly called "the Sunshine Law," is a frequent question. If the OMA (Ohio Rev. Code § 121.22) were to apply, the audit committee would be required to issue timely public notice of its meetings, permit public attendance at its meetings, and maintain minutes of its meetings. Depending on the composition of the committee and the directive given to the committee, the committee could be considered a "public body," which would render it subject to the provisions of the OMA. Because the case law varies throughout the state and relies heavily on the facts of each case, the AOS cannot provide a blanket statement as to whether these committees and their meetings are subject to the OMA requirements.

Additionally, OMA specifically states that the law does not apply to "an audit conference conducted by the auditor of state or independent certified public accountants with officials of the public office that is the subject of the audit." Accordingly, if the audit committee attends a meeting (a) conducted by the AOS, either directly or by an

independent public accountant on the auditor's behalf, and (b) with officials of the audited entity, and (c) during the course of an on-going audit, the AOS's position is that the resulting meeting is *not* subject to the OMA. In sum, the AOS raises these legal issues for consideration, and we urge every public entity to consult its legal counsel for advice.

Committee Functions

The National Commission on Fraudulent Financial Reporting (NCFRR, also known as the Treadway Commission) recommends the creation of an audit committee to enhance the credibility of an agency's financial reporting and to strengthen its internal control structure. In general, the audit committee serves in an advisory role to the governing body. Through its activities, the audit committee helps to reduce fraudulent financial reporting and helps to facilitate both internal and external audits.

As part of its activities, the audit committee reviews the draft financial statements, notes to the statements, and, if applicable, any accompanying information, such as the Management's Discussion and Analysis. The audit committee typically works with management and internal and external audit staff to select accounting standards, to discuss sensitive audit areas, and to resolve disagreements between management and audit staff. In working with the independent auditors, the audit committee should be apprised of the following matters:

- ✓ **Fraud and Illegal Acts** — Fraud in government usually consists of theft or illegal usage of the government's assets. The auditors should report material frauds, those that are going to be reported in the audit reports, and frauds involving key management employees. If applicable, the audit committee should also discuss any citations to state, federal, and local laws and regulations found during the audit.
- ✓ **Deficiencies in Internal Controls** — In the process of planning the audit, auditors may discover deficiencies in the government's internal control structure. The audit committee should be sure to discuss those deficiencies that will be reported in the publicly issued audit report [sometimes called the "GAGAS" report]. Matters of lesser significance, to be reported either in the management letter to the government or simply verbally, may be discussed with the audit committee if the committee so desires.
- ✓ **Auditor Responsibility and Expectations** — It is important for the audit committee to discuss and understand what the auditors are responsible for and what can be expected of them. In accordance with professional auditing standards, auditors are expected to provide "reasonable" assurance, not "absolute" assurance. For example, auditors test samples of a government's records; they do not examine all of its records. Therefore, some frauds may not be detected and it is not always reasonable to hold auditors responsible for finding them.
NOTE: We do look at 100 percent of our samples.
- ✓ **Significant Accounting Policies and Estimates** — Management often has some latitude in choosing accounting policies and in estimating certain items that appear in the audited financial statements. For example, management can decide the length of time over which it will depreciate its assets and how much to include in the financial statements. The audit committee should review these issues and understand management's rationale for choosing among the available options.
- ✓ **Significant Audit Adjustments** — In determining whether the government's overall financial statements were "fairly stated," the auditors must consider the significance of any adjustment made to the financial statements. Significant adjustments are those adjustments needed to make the government's financial statements accurate and not misleading. If management made these adjustments, how would the audit committee know they ever existed? Current audit standards require the auditors to communicate those to the audit committee, which in

turn can use this information to review management’s performance in creating the statements. The audit committee also, if it wishes, reviews adjustments that the auditors found that were of lesser significance that were not made to the statements.

- ✓ **Disagreements with Management and Consultation with Other Accountants** — Because accounting is not an exact science, sometimes management will disagree over how to treat a particular transaction. In some cases, they may consult with another accountant or audit firm. The audit committee should be made aware of such disagreements and consultations.
- ✓ **Difficulties Encountered in Performing the Audit** — While most governments cooperate with auditors so they can complete their audit engagement in a timely manner, sometimes management and auditors encounter problems during the audit. The audit committee should be informed of any significant problem encountered during the audit engagement so the committee can help facilitate a reasonable and timely solution.

If the auditors report any serious deficiencies in the government’s financial statements (e.g., significant legal non-compliance, fraud, or internal control deficiencies), the audit committee should carefully review these deficiencies and understand their impact upon the government. Additionally, the committee may want to serve as a liaison and review these reported deficiencies with the governing board.

Finally, if the government has its own “internal” auditors — those employed by the government itself — the audit committee often is responsible for reviewing their audit plans and resulting reports.

Establishing the Committee

According to the GFOA, the establishment of the audit committee should be formal. The governing body should adopt a resolution to create an audit committee. The committee should then develop bylaws by which it will be governed. Typical articles might include:

- ✓ Name and Purpose
- ✓ Powers and Duties
- ✓ Membership
- ✓ Appointment Terms and Conditions, including resignations
- ✓ Meetings; times, dates, and quorum requirements
- ✓ Committee compensations and expense reimbursement
- ✓ Amendments

The resolution establishing the committee might also describe what support the government will provide to the committee, such as staff support for maintaining minutes.

Furthermore, the audit committee should formally report its activities to the governing board and the community at least once a year. As part of the formal report, the audit committee should reiterate its designated responsibilities to ensure the governing board and management clearly understand the purpose of the committee. The report should also describe any significant accounting and audit issues that arose during the reporting period, including the results of the committee’s review of the government’s audit reports and financial statements.

Sample Documentation for Audit Committees

Sample Charter — Adapted from Glendale Federal Bank

<http://www.aicpa.org/pubs/jofa/jan1999/beanexh4.htm>

This sample audit committee charter appeared in the January 1999 issue of the *Journal of Accountancy*, published through the American Institute of Certified Public Accountants (AICPA). Although the charter was developed for a banking institution in the private sector, the charter does include a number of recommended provisions that are applicable to public sector audit committees.

Sample Resolution — Ross County

www.auditor.state.oh.us/publications/bestpractices/rosscounty

Although relatively straightforward, the Ross County board resolution represents a formal method by which a government can establish its audit committee. In addition to the resolution, the link includes a letter to the AOS regarding the creation of the audit committee. If you have any questions about the Ross County Audit Committee, you may contact Stephen A. Neal, Ross County Auditor, at (740) 702-3080.

Sample Ordinance, Meeting Agenda, and Meeting Minutes — City of Cleveland

www.auditor.state.oh.us/publications/bestpractices/cleveland

In 2000, the City of Cleveland enacted a thorough and comprehensive ordinance establishing its audit committee. The ordinance specifies the committee's purpose and various duties as well as meeting and attendance requirements. In addition to the ordinance, the link includes a sample agenda and minutes from prior audit committee meetings. If you have any questions about the City of Cleveland's Audit Committee, you may contact James Gentile, City Comptroller, at (216) 664-3871 or via email at jgentile@city.cleveland.oh.us. You may also contact Frank Badalamenti, Manager of Internal Audit, at (216) 664-4157 or via email at fbadalamenti@city.cleveland.oh.us.

Sample Proposal, Meeting Agenda, and Meeting Minutes — Springfield Township (Hamilton County)

www.auditor.state.oh.us/publications/bestpractices/springfield

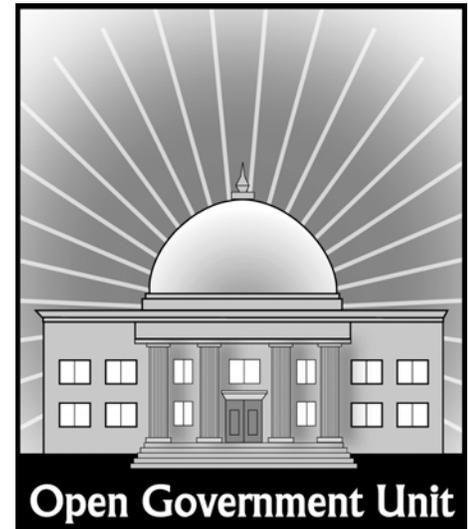
In response to an audit recommendation made by the AOS, Springfield Township established an audit committee in 2001. In addition to reviewing the biennial Township audit, the committee performs a number of financial monitoring functions for the Township. For example, the committee reviews the Township appropriation document and compares it to the certificate of estimated resources issued by the County Auditor. This link includes the formal proposal to establish the audit committee, sample meeting agendas, and meeting minutes. If you have any questions about Springfield Township's Audit Committee, you may contact Dorothy Carter, Springfield Township Financial Coordinator, at (513) 522-1410 or via email at dcarter@springfieldtwp.org.

Public Records

As Thomas Jefferson once said, “We think, in America, that it is necessary to introduce the people into every department of government, as far as they are capable of exercising it, and that this is the only way to ensure a long continued and honest administration of its powers.” For a representative government of the people, by the people, and for the people to be effective, it must conduct the people’s business in full public view. This guiding principal is the foundation of Ohio’s Public Records Act. In Ohio, records maintained by a public office belong to the people and, with a few exceptions, the people have an unconditional right to inspect and receive copies of their records. This article is an in-depth examination of Ohio’s Public Records Act, including the basic statutory requirements, common exceptions to mandatory disclosure, and various nuances of the Public Records Act.

An Office’s Responsibilities

Under Ohio’s public records law, every “public office”¹ must provide inspection of public records *promptly* and make copies of public records available within a *reasonable period of time*. These standards may differ with each request, and whether a public office has complied with these standards will be assessed by considering all the circumstances of the request. Some such considerations may include the current circumstances of the public office, the breadth of the request, and whether an attorney needs to evaluate the materials before their release.



A “public record” is a record held by a public office that is stored on a fixed medium, created, received or sent under the jurisdiction of a public office, and that documents what the office does. A record may take many forms, including paper, audio or video tape, a network server, a computer hard drive, negatives, photographs, film, etc.

Liabilities

All public employees and officials are commanded to *liberally construe* the public records law in favor of disclosure and to *narrowly construe* any exception to mandatory disclosure, again in favor of disclosure. If a public office is alleged to have violated the public records law, any person may initiate a court action to seek access to the records. This action is called a petition for a writ of mandamus, and the action may be filed in any one of the three levels of courts: the county common pleas court, the district appellate court, or the Ohio Supreme Court. If a public office loses a public records case, in addition to having to relinquish the record sought, it may also have to pay the citizen’s attorney’s fees.

Costs that May be Assessed

The Public Records Act does not permit a public office to charge for inspection of public records. However, when copies are requested a public office is permitted to charge its *actual cost* to reproduce the record, and “actual cost” does *not* include employee time to gather or review the records.

¹ Whether an office is a “public office” subject to the public records law is a fact-specific matter and must be assessed on a case-by-case basis. For additional information, see *Ohio’s Open Government Resource Manual*, pages 70-71.

This actual cost limitation does not apply to a public office with a statutorily prescribed fee. An office with such a statute may charge that fee, even though it likely exceeds its actual cost of duplication. The Ohio Supreme Court has not decided whether a charter community may pass valid legislation exceeding actual cost for copies of public records. Additionally, a public office has no duty to provide copies of public records *free of charge* to someone who indicates an inability or unwillingness to pay for them.

Transmitting Copies

If so requested, a public office must mail copies of responsive records by regular U.S. mail. Mailing records via a private carrier such as FedX or transmitting records by fax or e-mail is not required by statute, but may be accomplished at the office's discretion.

Written Request and Identification Requirements

Under the law, a public office *cannot* require a requester to submit a written request to inspect or copy public records or identify themselves or the reason they want the records. A public office *may ask* for a written request, but may not deny access based solely on a requester's refusal to provide a written request. The only exception to this rule is for a journalist seeking a peace officer, firefighter or EMT's residential or familial information. In that case, the journalist must submit a written request including the journalist's name and title, the employer's name and address, and a statement that disclosure of the information is in the public interest.



Common Problems and Suggested Remedies

"The liberties of a people never were, nor ever will be, secure, when the transactions of their rulers may be concealed from them. ... To cover with the veil of secrecy the common routine of business, is an abomination in the eyes of every intelligent man."

Patrick Henry

On a daily basis, the AOS's Open Government Unit is presented with problems related to granting or gaining access to public records. Some of the more common misconceptions public employees have and suggested remedies are shown below:

- **Responding to public records requests is not my job.** *Untrue.* Responding to requests for public records is part of every public employee's job. Proper training of all employees to sensitize them to this truth is critical. As a practical matter, in small public offices, all employees may need to be prepared to handle public records requests to facilitate responses in a timely manner. In larger offices, it may be possible and advantageous to have a department dedicated to public records.
- **The records belong to the public office.** *Untrue.* Public employees need to always remember that public records belong to the citizens who pay for the records through their tax dollars. Public employees are simply the custodians or caretakers of public records. They do not own the records. Again, the best remedy to this common problem is proper training of all employees to ensure that they are aware of their responsibilities under the public records law.

- **The public office is “too busy” to respond promptly to public records requests.** In these difficult economic times, public employees are asked to wear many hats, which makes the “I’m too busy” excuse very easy. However, as responding to public records request is part of every public employee’s job, this is an unacceptable excuse. Every office has a duty to maintain its records in a manner that allows it to efficiently respond to requests for access. Accordingly, a public office may want to consider designating one person as the public records officer whose primary duty is to respond to public records requests. At the very least, public employees must be trained to understand their obligations under the public records law as noted in the two *Common Problems* discussed above.
- **The public office must receive the request in writing before fulfilling it.** As was mentioned earlier, the law does not require a request for records to be in writing, except in one very limited circumstance.² A public office cannot require a written request as a condition of compliance. However, a public office is certainly permitted to ask the requester to put the request in writing. In more complex requests, this is beneficial to both the public office and the requester. It ensures that both parties understand what records are requested and can be used as a point of reference if questions do arise. For the requester, it provides a “paper trail,” documenting when a request was made to a public office.

Public Records Request Response Policies

AOS does not prescribe a form policy that a public office should adopt. Instead, public offices are encouraged to develop their own policies for responding to public records. The policy should be reviewed on an annual basis and edited to reflect changes in the public records law, etc. The following sample policies illustrate the varying approaches governments³ adopt with regard to public records requests:

Ohio University

<http://www.ohiou.edu/policy/40-007.html>

OU’s policy gives a brief overview of the public records law and instructs employees on the proper protocol for responding to a public records request.

Medical College of Ohio (MCO)

http://www.mco.edu/research/mco_policies/01-068.pdf

MCO’s policy provides an overview of the law including designating the types of records generally held by a public office, exceptions to the Public Records Act, and proper protocol for responding to a public records request.

Licking County Board of Elections

http://www.lcounty.com/boe/public_record_policy.php

The Licking County Board of Elections policy generally follows the Public Records Act (R.C. 149.43).

Ohio Historical Society

<http://www.ohiohistory.org/resource/archlib/refemail.html>

Rather than instructing employees on how to respond to public records requests, the Ohio Historical Society provides detailed instructions to requesters of public records. Reviewing this site may be helpful to public offices that maintain specialized or unique public records.

² See, discussion, above, related to a journalist’s request for residential and familial information of a peace officer, firefighter, or EMT.

³ Please note that the Auditor of State does not recommend or endorse any particular policy. These sample policies are merely provided as a springboard from which a public office can develop or enhance its own public records request policy.

An Update on Identity Theft and Recent Actions Taken by the Auditor of State

Identity theft occurs when a criminal steals an individual's personal information such as credit card numbers, bank account numbers, insurance information, and social security numbers to commit fraud or theft. According to the *2003 Identity Theft Survey Report*, issued by the Federal Trade Commission (FTC), an estimated 10 million Americans surveyed had discovered they had been victims of identity theft within a year of the study. This survey also estimates that the total cost of this crime approximates \$50 billion per year. On average, individuals lose \$4,800 each time a criminal steals their personal information. Additionally, these individuals spend a significant amount of time and money in their efforts to "clean-up" their credit records.

Federal Trade Commission — *ID Theft, What's It All About?*

<http://www.ftc.gov/bcp/online/pubs/credit/idtheftmini.pdf>

To help raise awareness of identity theft, the Federal Trade Commission recently published a booklet which contains helpful tips, guidelines, and other pertinent information that can be used to help prevent identity theft. Designed primarily for consumers, the booklet can be used by governments in their efforts to properly safeguard personal taxpayer information and to minimize risks associated with identify theft.

The AOS Takes Action Against Identity Theft

Clearly, governments play a unique role in protecting taxpayers from identity theft as nearly all governments maintain taxpayers' personal information to some degree. More specifically, understanding that Social Security Numbers (SSN) are often the prime targets of identity thieves, the AOS has taken action to protect this information for State employees, taxpayers who receive payments from the State, and those who do business with the State. More specifically, the AOS has implemented the following measures to safeguard SSNs:

- Replace SSNs with unique employee identification numbers on payroll earning statements. Prior to August 20, 2004, SSNs appeared on the pay stubs of some 60,000 State employees. By removing the SSNs from their pay stubs, the AOS dramatically reduces the risk of exposing this information as over 1.5 million earning statements are issued annually.
- Remove SSNs from State income tax refund checks. Currently, SSNs appear on over 3 million personal income tax refund checks issued by the State of Ohio annually, posing a significant risk to Ohio taxpayers. With authorization of the Ohio Department of Taxation, only the last four digits of the SSN will appear on refund checks beginning in January 2005.
- Remove SSNs from Medicaid, vendor payments, and reimbursement payments made by the State.



The AOS has taken steps to ensure only the last four digits of SSNs and the banking routing number appear on these documents. This should further protect over 500,000 electronic fund transfer statements that before may have exposed SSNs to possible identity theft.

While the AOS has taken steps to conceal and safeguard SSNs, **other governments should review their operations to identify areas in which taxpayers' personal information may be at risk.** Moreover, governments should ensure internal controls sufficiently address these areas of high risk and that all personal information is managed with caution.

Coming Up in the Next Issue of

BEST Practices

The next issue of this newsletter will focus on the fiscal watch and fiscal emergency process as well as other important issues. To provide additional guidance, sample policies and recommended practices associated with these areas will also be included.

If you would like your policies to be featured as samples in the next newsletter, please fax them to the Auditor of State's Office at (614) 466-4490 or you may e-mail them to bestpractices@auditor.state.oh.us (Please include any necessary contact information should questions arise).

Finally, if you like this publication and if you think it will be of help to you, please contact us at (800) 282-0370 or bestpractices@auditor.state.oh.us and let us know. If there are other areas in the audit arena you wish us to highlight or if you have any comments, concerns, or questions, please let us know. Your opinions are very important to us.