

## Association of Local Government Auditors

November 9, 2012

Martin Matson  
Comptroller  
200 East Wells Street  
Milwaukee, WI 53202

Dear Mr. Matson,

We have completed a peer review of the City of Milwaukee Comptroller's Office – Audit Division for the period July 1, 2011 through June 30, 2012. In conducting our review, we followed the standards and guidelines contained in the *Peer Review Guide* by the Association of Local Government Auditors (ALGA).

We reviewed the internal quality control system of your audit organization and conducted tests in order to determine whether your internal quality control system operated to provide reasonable assurance of compliance with *Government Auditing Standards* issued by the Comptroller General of the United States. Our procedures included:

- Reviewing the audit organization's written policies and procedures.
- Reviewing internal monitoring procedures.
- Reviewing a sample of audit reports and work papers.
- Reviewing documents related to independence, training, and development of auditing staff.
- Interviewing auditing staff and management to assess their understanding of, and compliance with, relevant quality control policies and procedures.

Due to variances in individual performance and judgment, compliance does not imply adherence to standards in every case, but does imply adherence in most situations.

Based on the results of our review, it is our opinion that the City of Milwaukee Comptroller's Office – Audit Division internal quality control system was not suitably designed and was not operating effectively to provide reasonable assurance of compliance with *Government Auditing Standards* for audits during the period July 1, 2011 through June 30, 2012.

We found serious deficiencies in your internal quality control system relating to independence and quality control. These control deficiencies resulted in recurring nonconformance with overall structural independence, independence related to auditing one's own work, the independence of specialists, and quality control monitoring and documentation.

We offer the following observations and suggestions to help your organization achieve full compliance with *Government Auditing Standards*:

Standard 3.02 & 3.03b require that "the audit organization and the individual auditor, whether government or public, must be independent" and that "independence comprises independence in appearance." Independence in appearance is defined as "the absence of circumstances that would cause a reasonable and informed third party, having knowledge of the relevant information, to reasonably conclude that the integrity, objectivity, or professional skepticism of an audit organization or member of the audit team had been compromised."

Additionally, Standard 3.04 requires that "Auditors and audit organizations maintain independence so that their opinions, findings, conclusions, judgments, and recommendations will be impartial and viewed as

impartial by reasonable and informed third parties. Auditors should avoid situations that could lead reasonable and informed third parties to conclude that the auditors are not independent and thus are not capable of exercising objective and impartial judgment on all issues associated with conducting the audit and reporting on the work."

Furthermore, Standard 3.10 states, "For consideration of auditor independence, offices or units of an audit organization, or related or affiliated entities under common control, are not differentiated from one another. Consequently, for the purposes of independence evaluation using the conceptual framework, an audit organization that includes multiple offices or units, or includes multiple entities related or affiliated through common control, is considered to be one audit organization. Common ownership may also affect independence in appearance regardless of the level of control."

Standard 3.14 requires auditors to evaluate the broad categories of threats to independence including structural threats. Standard 3.14g identifies a structural threat as "the threat that an audit organizations' placement within a government entity, in combination with the structure of the government entity being audited, will impact the audit organizations' ability to perform work and report results objectively." Standard 3.22 requires auditors to then "determine whether identified threats to independence are at an acceptable level or have been eliminated or reduced to an acceptable level. A threat to independence is not acceptable if it... (b) could expose the auditor or audit organization to circumstances that would cause a reasonable and informed third party to conclude that the integrity, objectivity, or professional skepticism of the audit organization, or a member of the audit team, had been compromised."

Supplemental Guidance in Appendix I, paragraphs A3.04b & d and 3.08b also state that the following situations create self-review and management participation threats to independence:

"An audit organization having prepared the original data used to generate records that are the subject matter of the audit...A member of the audit team being, or having recently been, employed by the audited entity in a position to exert significant influence over the subject matter of the audit...An audit organization principal or employee serving as a voting member of an entity's management committee or board of directors, making policy decisions that affect future direction and operation of an entity's programs, supervising entity employees, developing or approving programmatic policy, authorizing an entity's transactions, or maintaining custody of an entity's assets."

We observed that the City of Milwaukee Comptroller's Office – Audit Division reports directly to an elected comptroller. However, as documented in city ordinances, state statute, and Audit Division policy and procedures, the elected Comptroller is required to perform duties and has responsibility for functions throughout the government that create a significant impairment to the independence of the audit function under *Generally Accepted Government Auditing Standards*.

Examples of the Comptrollers duties and responsibilities that impair the independence of the Audit Division include:

- Comptroller prescribes methods of accounting (accounting policies and procedures) for all city departments, commissions, and boards.
- Comptroller produces the Comprehensive Annual Financial Report for the City.
- Other duties/powers include establishing a voucher system.
- No contract entered into or certificate issued against property shall be of any validity unless countersigned by the comptroller.
- The Accounting Division reports directly to the Comptroller.
- Comptroller is responsible for payroll.
- Public Debt – Comptroller attends meetings, countersigns all bonds, maintains accurate records of all bonds issued by the city and the purpose for each bond. Notes in anticipation of tax revenues to be received in the next year are signed by the mayor and comptroller. All bonds and notes shall be signed by the comptroller.

- Except for electronic fund transfers for investing or reallocating city funds, which are done by the treasurer, the comptroller signs or countersigns all disbursements of city funds, except city debt. The comptroller reviews transfers made by the treasurer and periodically reports them to common council.
- Exercise control over the financial concerns of the city and to prescribe the forms for the methods of keeping and rendering all city accounts.
- On January 25th of each year, adjust and close all the city's accounts for the year ending on the 31st day of December of the preceding calendar year, and submit to the common council with his annual report a copy of the trial balance of his books at said date.
- Cancelling city claims
- Liability Insurance – Comptroller administers, supervises and controls liability insurance policies. Comptroller keeps records of liability insurance coverage and annually reports all city coverage to common council.
- Delinquent Tax Fund – Comptroller prescribes accounting procedures and makes transfers for this fund as instructed by common council.
- Comptroller writes procedures for preparing grant budgets and administering grant funds.
- Comptroller determines whether a grant should be classified as operating or capital.
- Individual grant accounts are established by the comptroller, and the comptroller is responsible for the accounting system used for the grant project.
- Comptroller is a voting member of the following boards/committees:
  - **Purchasing Appeals Board**, which hears specification and award appeals. If purchasing director authorizes a department, board or commission to purchase special equipment independently, the related purchase contract is countersigned by the comptroller.
  - **Deferred Compensation Plan Board**
  - **City Information Management Committee** – the committee recommends policies, reviews and recommends approval of citywide IT strategic plans, assists the chief information officer in analysis of and recommendations on IT issues, and provides guidelines for development and maintenance of the city's records management program.
  - **Capital Improvements Committee** – The committee develops a prioritized 6-year capital improvements program for all departments under control of common council, and establishes criteria for determining the priority of each capital program or project.

Given the comprehensive responsibilities of the position, we observed that the Audit Division either directly or indirectly conducts audits that fall within the reporting lines under the authority and control of the Comptroller. You produce the CAFR and are responsible for prescribing the methods of accounting (accounting policies and procedures) for all city departments, commissions, and boards. On 8 of 13 audits reviewed, the subject matter of the audit dealt with accounting and financial matters. Additionally, you have common ownership over accounting and auditing and sign all audit reports. Therefore, the perception is that you could influence the audit results, especially if it adversely affected any of the other areas for which you are responsible, as well as which audits the Audit Division performs during the year. At the very least, this violates the basic premise of maintaining independence in appearance.

To ensure the independence of the Audit Division both of mind and in appearance, we recommend that you evaluate the structure of the Audit Division and consider organizing the Division so that it no longer reports to you, but directly to the Common Council or to an audit committee.

Standards 6.42 & 6.44 state that "some audits may necessitate the use of specialized techniques or methods that require the skills of a specialist"...and require that auditors "assess the professional qualifications and independence of the specialists...Auditors' assessment of the independence of specialists who perform audit work includes identifying threats and applying any necessary safeguards in the same manner as they would for auditors performing work on those audits."

We reviewed two IT audits and observed that there was no assessment of the independence of the specialist used to perform the audits.

We recommend that the Audit Division evaluate outside experts' independence before using their services and that they document these evaluations in the work papers.

Standards 3.85 & 3.95 require an audit organization to "establish policies and procedures in its system of quality control that collectively address (a.) leadership responsibilities for quality within the audit organization; (b.) independence, legal, and ethical requirements; (c.) initiation, acceptance, and continuance of audits; (d.) human resources; (e.) audit performance, documentation, and reporting; and (f.) monitoring of quality." The standards also require the audit organization to "analyze and summarize the results of its monitoring process at least annually, with identification of any systemic or repetitive issues needing improvement, along with recommendations for corrective action. The Audit Division should communicate to appropriate personnel any deficiencies noted during the monitoring process and make recommendations for appropriate remedial action."

We found that sections of the Policies and Procedures Manual did not specifically state how the Audit Division would meet the requirements of these standards. There was also no documented evidence that the Audit Division performed an annual monitoring process summarizing the results and identifying any systemic or repetitive issues needing improvement.

We recommend the Audit Division establish clear, written policies and procedures which define how the Division implements the standards as defined in the ALGA Quality Control System and related to:

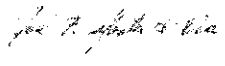
- Independence (GAS 3.25)
- Independence: Non-Audit Services (GAS 3.37 – 3.39, 3.55, 3.59)
- Quality Control and Assurance (GAS 3.82, 3.84 – 3.95)
- Performance Audit Planning (GAS 6.12d – e, 6.32, 6.34 – 6.35, 6.39, 6.45 – 6.50)
- Supervision (GAS 6.53, 6.83c)
- Evidence (GAS 6.56 – 6.58, 6.62, 6.65 – 6.67, 6.69, 6.71 – 6.72)
- Reporting (GAS 7.14 – 7.18)

We also recommend that the Audit Division perform and document a monitoring process summarizing the results and identifying any systemic or repetitive issues needing improvement, at least annually, along with recommendations for corrective action. The Audit Division should communicate to appropriate personnel any deficiencies noted during the monitoring process as well as the recommendations for corrective action.

We have prepared a separate letter providing other useful, less significant observations and suggestions for strengthening your internal quality control system.



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City of Garland, Texas



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Miami-Dade County Public Schools, Florida



/s/ Chris Constantin  
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