



OFFICE OF INSPECTOR GENERAL

Thomas J. Dagley
Inspector General

September 26, 2008

Michael J. Knapp, President, County Council

President Knapp:

The purpose of this letter is to report the results of our review of County oversight practices and internal controls for selected financial reporting. A key objective was to assess the role of oversight parties, including Council committees, to help ensure: management of all Council-funded¹ organizations adheres to a sound system of internal controls; procedures are in place to objectively assess management practices; and auditors, through their own risk assessment and reviews, objectively assess financial activities. Another objective was to address anti-fraud programs in the County, including the use of practical mechanisms (i.e. hotlines) to permit the confidential, anonymous reporting of questionable accounting and other practices to appropriate responsible parties.

To accomplish our objectives, we reviewed: guidelines and recommended practices issued by the Government Finance Officers Association (GFOA), American Institute of Certified Public Accountants (AICPA), and U. S. Government Accountability Office (GAO); financial oversight and fraud prevention policies and procedures for selected Council-funded organizations; Council committee agendas; internal audit reports; management letters issued by external auditors; and other County information as deemed necessary. In addition, we met with Council members and staff, external auditors, and managers in Council-funded organizations.

Our finding is as follows: by establishing and operating a formal audit committee in accordance with guidelines issued by the GFOA² and AICPA³, the Council can improve its independent review and oversight for financial reporting, management control, and audit activities for County Government and other Council-funded organizations.

¹ In addition to the Executive Branch, Council-funded organizations include the: Montgomery County Public Schools; Maryland-National Capital Park and Planning Commission; Washington Suburban Sanitary Commission; Montgomery College, Housing Opportunities Commission; Revenue Authority; and any other government agency (except a municipal government or a State-created taxing district) for which the Council appropriates or approves funding, sets tax rates, or approves programs or budgets.

² GFOA recommends that the governing body of every state and local government establish an audit committee, or its equivalent.

³ The "AICPA Audit Committee Toolkit: Government Organizations" provides valuable information and tools to help a governing body and its officials create an effective audit committee function to help improve fiscal accountability.



As the governing body that appropriates Montgomery County operating and capital improvements program (CIP) funds, the Council has the ultimate authority and accountability of the County's public resources (for fiscal year 2009, the Council approved more than \$4 billion in annual operating funds and approximately \$3.4 billion for more than 500 CIP projects). We found that although the Council's current six-committee structure includes use of external auditors to provide reasonable assurances that Council-funded organizations prepare financial statements in conformity with generally accepted accounting principles, the structure is not designed to provide the oversight for financial reporting, internal controls, and auditors' activities recommended for an audit committee. Recommended practices for audit committees include:

- Inquiries of executive leadership, management and independent auditors regarding significant risks or exposures facing the organization(s) to assess the steps taken or needed to minimize the risks;
- Review with executive leadership, management and independent auditors the audit scope and plan of internal auditors and independent auditors; address the coordination efforts needed to assure completeness of coverage, reduction of redundant efforts, and the effective use of audit resources;
- Review with executive leadership and management the significant findings on internal and independent audits;
- Periodically review the organization's code of conduct to ensure a clear set of guiding principles are in place regarding legal and ethical behavior for all employees and contractors involved with activities funded by the governing body;
- Ensure policies and procedures are in place to encourage and facilitate the reporting of fraud or abuse and questionable accounting or auditing practices; ensure that those responsible for receiving and addressing complaints document the disposition of each so they can be periodically assessed.

In addition, the GFOA and/or AICPA recommend the following best practices that we believe should be considered by the Council incident to making an audit committee decision:

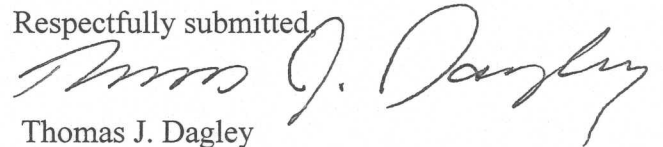
- Audit committees should be formally established (i.e. through legislation or other appropriate legal means);
- Members should possess or obtain a basic understanding of government financial reporting or auditing; at least one member should have financial experience;
- Committees should meet at least four times per year, and at additional times when necessary to assess and respond to issues raised as a result of audit work and reviews, or reports of suspected fraud;
- Members should be clear on the difference between audit (i.e. compliance with government auditing standards) and non-audit services. Under AICPA and GAO standards, for example, auditors have certain responsibilities for detecting fraud and illegal acts and determining whether those charged with governance are adequately informed.

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During our discussions with Council members and staff in July and August 2008, we emphasized the wealth of resources available through the GFOA, AICPA, GAO, Association of Government Accountants (AGA), and Association of Certified Fraud Examiners (ACFE) to learn more about audit committee best practices. We also began to examine how Montgomery County's finance officers, auditors, Office of Inspector General, and Office of Legislative Oversight can be used as a resource to openly discuss the steps needed to establish and implement a Council audit committee.

If you have any questions concerning our review, please do not hesitate to contact me.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Thomas J. Dagley". The signature is written in a cursive style with a large, sweeping "T" and "D".

Thomas J. Dagley
Inspector General