



CITY OF DUNWOODY

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MEMORANDUM

To: Mayor and City Council
From: Chris Pike, Finance Director
Date: September 21, 2009
Subject: **Audit Committee Discussion**

During the August 24, 2009 Council meeting, Council discussed its desire to consider the formation of an audit committee. Many private sector corporations increasingly are being subjected to civil and criminal actions for financial statements that are inaccurate or inadequate. Because of its many responsibilities, it may not be practicable for the full Council to consider financial reporting matters in depth. An audit committee can do this more effectively because it is often smaller than the full Council, is typically composed of members who are independent of management, and is able to concentrate more attention on this aspect of the government. The existence of an effective audit committee demonstrates the Council's commitment to the exercise of due care in reviewing financial information to be released to the public.

Another benefit of an audit committee is a better-informed Council more capable of executing its responsibilities to the citizens. An effectively functioning audit committee, with the help of the City's auditors, is able to identify and analyze financial reporting problems and to discuss its recommendations with the full Council in a comprehensive and effective manner. Thus, although an audit committee cannot relieve the full Council of its ultimate responsibility for the financial statements, a capable audit committee can help evaluate those financial statements.

An audit committee also enhances the external audit function. An effective external audit must be an independent audit. Relationships do—and should—exist between management and auditor, because an audit should be carried out in an atmosphere of full and open communication. These relationships must be carefully balanced. Both management and auditor must always be mindful of their ultimate responsibility to the citizens. An audit committee that carefully monitors the audit function lends assurance that this responsibility is kept in clear view. It also provides the auditor with a forum that is independent of operating management for discussion of matters considered significant. Accordingly, an audit committee enhances the independence of the external auditor, increases management's diligence in instituting internal accounting controls and appropriate reporting practices, and increases the participation of Council in the important decisions made as the result of an external audit.

I would encourage the formation of an audit committee. Following is suggested language for such a policy related to an audit committee.

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AUDIT COMMITTEE POLICY

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Developed under the Authority of the City Council, and approved by ordinance

This policy document is designed to provide comprehensive guidance to the Audit Committee members in performing their oversight function. As approved by Council, this policy will apply to all members of the Audit Committee. Members seeking clarification or interpretation and those who wish to comment on the Audit Committee Policy should contact the City Attorney. This policy should be reviewed annually and updated as needed.

SECTION I. FRAMEWORK

A. PURPOSE

The Council and employees are expected to achieve and maintain a high level of governance and transparency. The existence of the Audit Committee provides assistance in this regard by being an independent instrument of control and a review organ. The Audit Committee exists to provide assistance to the Council and City Manager in carrying out its responsibilities. The Audit Committee shall also be responsible for the overseeing and assessing the adequacy and scope of the arrangement for the management of the auditor functions.

B. PRINCIPLES

- a. The creation of Audit Committees within the City will contribute to good corporate governance and thereby improve both efficiency and accountability in the public sector.
- b. The main role of the Audit Committee is to provide independent, effective oversight on the financial reporting process and internal controls of the City.
- c. The Audit Committee is appointed to give advice to the City Manager on the adequacy of audit arrangements (internal and external) and on the assurances provided in respect of risk and control in the City.
- d. The Audit Committee shall have no executive powers and shall not be responsible for the preparation of financial statements or the implementation of proper systems of internal controls.

SECTION II. GUIDELINES

A. STRUCTURE OF THE AUDIT COMMITTEE

- a. Composition of an Audit Committee
 - i. There shall be 5 members on the Audit Committee. A minimum of 3 of the 5 members shall be independent. "Independent" for the purpose of this policy means that the member is not a city employee, appointed or elected official of the City or its contractors or any other individual having a relationship that would interfere with the exercise of independent/impartial judgment in carrying out the responsibilities of the Audit Committee.

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- ii. Members should exhibit adequate analytical, financial and managerial expertise in order that issues may be comprehensively addressed. To this end it is recommended that the Committee be made up of a balance of skills including at least a majority of individuals with technical skills and experience in financial and managerial matters.
- iii. The following individuals shall not be appointed to the Audit Committee as voting:
 - 1. The Finance Director (though shall serve on the Audit Committee in a non voting ex-officio capacity)
 - 2. The City Manager (though may be called upon to serve on the Audit Committee in an advisory role)
 - 3. The City Attorney
 - 4. Any employee on the staff of the selected City Auditor.

b. Appointment of Audit Committee Members

- i. As needed, the Mayor may request from the Council members a list of nominees along with their respective qualifications.
- ii. The City Clerk shall notify nominees to determine if they are willing to fulfill the obligations of an Audit Committee member.
- iii. A final list of acceptable and accepting nominees shall be submitted to the Mayor.
- iv. The Mayor shall appoint members (upon the Consent of Council) to the Audit Committee .
- v. The Mayor shall designate an Audit Committee Chairperson and a Vice Chair who shall serve in these capacities until a replacement is appointed, expiration of tenure, or upon resignation.

c. Compensation of the Audit Committee

Members of the Audit Committee will serve as volunteers without compensation for their services on the Audit Committee. Reasonable and preapproved expenditures will be reimbursed.

B. AUDIT COMMITTEE TENURE

a. Tenure of the Audit Committee

In order to ensure that the level of objectivity is maintained, and that any conflict of interest whether real or perceived is minimized, guidelines relating to the tenure of Audit Committees are as follows:

- i. Committee members shall serve for a minimum of three (3) years and a maximum of seven (7) years consecutively. However, this would not bar any such member from further service.

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- ii. At the end of the assigned term, committee members may indicate their willingness to serve for an additional term; provided no additional term shall cause the member to exceed the seven year limit. This should be communicated in writing to the City Clerk.
- iii. In the interest of continuity, an outgoing Chairperson who has served seven years may serve for an additional year but not as the Chairperson of the incoming Audit Committee.
- iv. In the interest of continuity, the Mayor shall assign (stagger) the terms of the Audit Committee members in a manner that provides an optimum level of experience on the Audit Committee.

b. Resignation from an Audit Committee

An Audit Committee member, who wishes to resign, should give one month's notice in writing to the Chairperson and the City Clerk outlining the reasons. In the case of the Chairperson, the members of the Audit Committee should also be informed of the resignation.

c. Expiration of an Audit Committee member's term

Members resigning from the committee upon the expiration of their tenure, should tender a letter of resignation to the Chairperson and City Clerk. All records should be handed over to the Chairperson, which will be made available to the Audit Committee.

d. Dismissal of an Audit Committee member

The following are possible circumstances, which may lead to the dismissal of an Audit Committee member:

- i. Failure to attend three consecutive meetings
- ii. Lack of Independence/Conflict of Interest
- iii. Any other reason that the committee may deem to be just and credible

If any of the above should occur, the Chairman must refer the case, in writing, to the Mayor outlining the circumstances and recommending that the member be replaced. A copy of the correspondence should be given to the member. The Mayor shall review the circumstances and state in writing his position to the Audit Committee within one month of receipt.

If the Mayor concurs with the recommendation of the Audit Committee Chairman, he should appoint a replacement using the appointment procedures outlined above. Where the Mayor disagrees with the Audit Committee Chairman's recommendations, the Audit Committee member will remain on the Audit Committee.

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C. AUDIT COMMITTEE AUTHORITY AND RESPONSIBILITIES

The Authority of the Audit Committee shall include but not be limited to:

- a. Seek and obtain any information it requires from any employee and external parties.
- b. Invite officers, employees, and auditors of the City to meetings, as appropriate.

The Responsibilities of the Audit Committee shall include but not be limited to:

- a. Reviewing and providing comment on the annual audit plans, budgets and schedules (to ensure sufficient audit coverage)

It is not appropriate for the audit committee to attempt to limit the scope of the audit. However, it is appropriate to query both management and the auditor about improvements that could be made (for example, in internal accounting controls) that would enable the auditor to reduce the scope of work. The Audit Committee might also ask about additional services that could be of benefit to the company. The external auditor may summarize his understanding of the services to be rendered in an engagement letter. The Audit Committee should receive and review that document at least 5 business days prior to the City Manager signing.

- b. Perusing, reviewing, and discussing audit reports

The Audit Committee should meet with management and the external auditor to review the financial statements and the audit results. This is an especially important function of the audit committee.

The Audit Committees may confine their review of the financial statements to major or critical items or may examine the statements in considerable detail. The scope of the review is something each Audit Committee establishes, bearing in mind that at the conclusion of the meeting the members should have a comprehensive understanding of any major financial reporting problems encountered, how they were resolved, and whether the resolution is satisfactory. Factors affecting the extent of the review include the committee's confidence in management, the system of internal accounting control, and the auditor; the existence of any unresolved differences between the auditor and management; the extent of adjustments or additional disclosures, if any, proposed by the auditor; and any unusual occurrences during the year. The committee's major concern throughout the review should be whether the financial statements fairly present the company's financial results in conformity with generally accepted accounting principles.

Upon completion of its considerations, the Audit Committee should be in a position to make a report to the Mayor on the financial statements and on the execution of the audit function.

- c. Requesting investigation of specific areas as needed

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- d. Recommending the City Auditor to Council, which shall include the following processes:
 - i. Authorize the release of Requests for Auditing Services Proposals with standards outlined by the Georgia Department of Audits and OCGA;
 - ii. Review proposals from auditing firms to qualify the firms' experience, the audit team, approach, quality control procedures, timetable, scope, personnel training, and fees;
 - iii. Request presentations and interviews of the proposers; and
 - iv. Shortlist no less than three proposers for Council consideration.
- e. Performing other appropriate responsibilities as requested by the Mayor

SECTION III. ETHICS

All members of the Audit Committee have a fiduciary responsibility to demonstrate due professional care and proficiency at all times. In order to optimize their performance, they should seek relevant professional assistance where necessary. They should be and be seen to be independent of the management and audit functions. This will allow them to display objectivity and avoid cases of conflicts of interest. If there is a change in circumstances, causing a member's independence to be impaired, then that member should resign in accordance with this policy.

Where the independence of a member is impaired, but he/she is not willing to resign, the majority of the committee members shall indicate in writing their concerns and make recommendations for the member's removal in accordance with this policy.

All members must complete at least two hours of ethics training within six months of appointment and again in no less than once every two years.

SECTION IV. PERFORMANCE OF THE AUDIT COMMITTEE

A. THE OPERATION OF THE AUDIT COMMITTEE

- a. The Chairperson, upon consulting with the Finance Director and/or City Auditor shall schedule meetings as needed and may invite attendees to meetings.
- b. A quorum should be present prior to the commencement of meetings. A quorum shall consist of a majority of the membership.
- c. In instances where it is considered necessary, the requisite accounting or other personnel may be invited to answer any questions of the Committee pertaining to their area of responsibility.
- d. The Committee should also request responses from the Finance Director identifying the actions taken to implement the audit recommendations given and should continue to monitor the responses and corrective actions implemented.

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- e. The Committee should periodically review and evaluate the audit activity to ensure that the scope and audit approach being applied are relevant to achieve the desired objectives of the entity.
- f. Audit reports should be circulated to the audit committee members within five working days before the proposed committee meeting.
- g. The Committee shall review the audit reports, analyze audit issues and evaluate the adequacy of recommendations and the responses of the Finance Director. The Committee must ensure that these issues are dealt with adequately and satisfactorily.
- h. The duration of the meetings should allow adequate discussion of the issues.
- i. Sufficient interval should be allowed between Audit Committee meetings and Council meetings to allow follow-up actions to be effected.
- j. The Chairperson shall request the City Clerk to provide a secretary for the committee, or may appoint one of its members to be the secretary of the committee. The secretary shall assist the Chairman in:
 - i. Preparing agendas for meetings
 - ii. Drafting minutes and annual report of the committee's activities
 - iii. Collecting and disseminating information

B. REPORTING RESPONSIBILITIES OF THE AUDIT COMMITTEE

The Audit Committee reports are intended to provide information on a global level, of the anomalies noted by the audit functions and how and when these were resolved. The reports help to monitor the improvements made in the internal control environment as a result of the audit activity.

The Audit Committee shall present a report after each committee meeting to the Council within four weeks after each Audit Committee meeting. The report will highlight the following:

- a. Discussions and decisions on audit issues
- b. Internal control plan and status report
- c. Updates on outstanding management responses

The Audit Committee should submit an exception report to the City Manager as needed, outlining any negative trends, for example, lack of management response. The City Manager will communicate with the Finance Director in an effort to resolve outstanding issues. Where these have not been resolved, the issues should be presented to the Council for further discussion.

The Committee should also prepare an annual report within four months of the end of the financial year, comprising all major activities for the year. This report should be submitted to:

- a. The Mayor and Council

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- b. The Finance Director.
- c. The City Manager
- d. Audit Committee members

The annual report may include but is not limited to the following:

- a. Details of attendance at meetings
- b. Conclusion on the adequacy and effectiveness of internal controls in the City
- c. General comments on the quality of internal audit reports submitted
- d. Results of the evaluation of financial and other data.

C. TRAINING OF THE AUDIT COMMITTEE MEMBERS

The City Manager in conjunction with the Finance Director will make provision for training Audit Committee members on an on-going basis to fulfill the responsibility of ensuring that Audit Committee members are kept abreast of current financial and audit practices as well as the operations unique to the City.

D. AUDITOR/AUDIT COMMITTEE RELATIONSHIP

The senior member of the audit team(s) shall have the right of access to the Audit Committee. The lines of communication should facilitate independence from management and encourage auditors to speak freely, regularly and on a confidential basis with the Audit Committee.

The Audit Committee should provide an open avenue of communication between the auditors and the Finance Director.