

## **FINANCIAL MANAGEMENT PRACTICES**

The role and responsibility of financial management within each city is to manage and protect the financial resources and assets of the city. This includes planning, organizing, directing and controlling the financial activities of the city. It also requires establishing adequate systems of internal controls to ensure funds are used for their intended purposes. The transparency and reliability of financial reporting is also key, ensuring that such reporting is consistent with appropriate standards.

The Government Finance Officers Association (GFOA) is the association for public sector financial management professionals. Its purpose is to enhance and promote the professional management of governments for the public benefit by identifying and developing financial policies and best practices and promoting their use through education, training, facilitation of member networking, and leadership.

Beginning in 1993 the GFOA began to develop a body of recommended practices in the functional areas of public finance to give GFOA members and other state and local governments more guidance on sound financial management practices. These recommended practices served as the basis for evaluating the financial management practices of the charter cities discussed in the following sections.

### **Audit Committee**

The audit committee can provide a forum for auditors and other interested parties to candidly discuss concerns separate from the management of the city.

The responsibility for the quality of financial reporting by cities is shared by three groups: the city council (governing board), finance department management, and the independent auditor. Of these three, the city council is in the unique position of being the ultimate monitor of the financial reporting process. An audit committee is a practical approach for the city council to provide independent review and oversight of the city's financial reporting processes, internal controls, and independent auditors.

The audit committee can also provide a forum for auditors and other interested parties to candidly discuss concerns separate from the management of the city. An effective audit committee helps ensure management develops and follows a sound system of internal controls; procedures are in place to objectively assess practices; and independent auditors objectively assess financial reporting practices.

The following are excerpts from the GFOA recommended best practice regarding audit committees:<sup>3</sup>

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<sup>3</sup> GFAO Best Practices and Advisories website  
[http://www.gfoa.org/index.php?option=com\\_content&task=view&id=118&Itemid=130](http://www.gfoa.org/index.php?option=com_content&task=view&id=118&Itemid=130)

The governing body of every state and local government should establish an audit committee or its equivalent;

The audit committee should be formally established by charter, enabling resolution, or other appropriate legal means and made directly responsible for the appointment, compensation, retention, and oversight of the work of any independent accountants engaged for the purpose of preparing or issuing an independent audit report or performing other independent audit, review, or attest services. Likewise, the audit committee should be established in such a manner that all accountants thus engaged report directly to the audit committee. The written documentation establishing the audit committee should prescribe the scope of the committee’s responsibilities, as well as its structure, processes, and membership requirements. The audit committee should itself periodically review such documentation, no less than once every five years, to assess its continued adequacy;

**Formal Audit Committee**

Table 14. Formal Audit Committee							
Alhambra	Arcadia	Bell	Burbank	Cerritos	Compton	Culver City	Downey
No	No	No	Yes	No	No	Yes	Yes
Glendale	Industry	Inglewood	Irwindale	Lancaster	Palmdale	Pasadena	Pomona
Yes	No	No	No	Yes	No	Yes	No
Redondo Beach	Santa Monica	Signal Hill	Temple City	Torrance	Vernon	Whittier	
Yes	No	No	No	No	Yes	No	

As shown in Table 14, most charter cities (8 yes, 15 no) responded that no audit committee had been established by the city. The CGJ requested each city provide a copy of the formal document establishing the audit committee. In reviewing this supporting documentation and comments provided by each city, the CGJ found several cities had formally established an audit committee. Redondo Beach established an audit committee as a standing committee in 2008. The Pasadena City Charter formally gives the finance committee the responsibility to perform the functions of an audit committee. Burbank also has an audit committee of the city council, which reviews and approves all financial audit services. Lancaster has appointed one member of the city council as the “audit representative” and considers that to be an audit committee.

Other cities stated that the audit committee responsibilities were assigned to other committees of the city council, such as the finance or budget committee. Glendale has an audit committee of members of the community rather than members of the city council. For other cities the audit committee is a function of management, with members from the finance department and other areas of the city government.

Only the cities of Glendale and Pasadena had a formal audit committee, and each responded that the committee was directly responsible for the work of the independent auditor.

### **Audit Procurement**

Independent audits play a key role in preserving the integrity of public finance functions and maintaining public confidence in city government.

Each of the charter cities is required by its charter to have an independent audit performed annually by external accountants. The selection of the independent auditor is an important element of ensuring an independent and quality audit. This includes ensuring the selected auditor meets standards for independence, is selected competitively, and provision of non-audit services by the auditor are carefully reviewed and approved.

The following are excerpts from the GFOA recommended best practice regarding audit procurement:

Governmental entities should require in their audit contracts that the auditors of their financial statements conform to the independence standard promulgated in the General Accounting Office's Government Auditing Standards even for audit engagements that are not otherwise subject to generally accepted government auditing standards.

Governmental entities should enter into multiyear agreements of at least five years in duration when obtaining the services of independent auditors. Such multiyear agreements can take a variety of different forms (e.g., a series of single-year contracts), consistent with applicable legal requirements. Such agreements allow for greater continuity and help to minimize the potential for disruption in connection with the independent audit. Multiyear agreements can also help to reduce audit costs by allowing auditors to recover certain "startup" costs over several years, rather than over a single year.

Governmental entities should undertake a full-scale competitive process for the selection of independent auditors at the end of the term of each audit contract, consistent with applicable legal requirements. Ideally, auditor independence would be enhanced by a policy requiring that the independent auditor be replaced at the end of the audit contract, as is often the case in the private sector. Unfortunately, the frequent lack of competition among audit firms fully qualified to perform public-sector audits could make a policy of mandatory auditor rotation counterproductive. In such cases, it is recommended that a governmental entity actively seek the participation of all qualified firms, including the current auditors, assuming that the past performance of the current auditors has proven satisfactory. Except in cases where a multiyear agreement has taken the form of a series of single-year contracts, a contractual provision for the automatic renewal of the audit contract (e.g., an automatic second term for the auditor upon satisfactory performance) is inconsistent with this recommendation.

Professional standards allow independent auditors to perform certain types of non-audit services for their audit clients. Any significant nonaudit services should always be approved in advance by a governmental entity's audit committee. Furthermore, governmental entities should routinely explore the possibility of alternative service providers before making a decision to engage their independent auditors to perform significant nonaudit services.

The audit procurement process should be structured so that the principal factor in the selection of an independent auditor is the auditor's ability to perform a quality audit. In no case should price be allowed to serve as the sole criterion for the selection of an independent auditor.<sup>4</sup>

Table 15. Independent Standards							
Alhambra	Arcadia	Bell	Burbank	Cerritos	Compton	Culver City	Downey
Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Glendale	Industry	Inglewood	Irwindale	Lancaster	Palmdale	Pasadena	Pomona
Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Redondo Beach	Santa Monica	Signal Hill	Temple City	Torrance	Vernon	Whittier	
Yes	Yes	Yes	Yes	Yes	Yes	Yes	

As shown in Table 15, all charter cities (23 yes, 0 no) responded that audit contracts require auditors of financial statements conform with independence standards. The CGJ obtained the audited financial statements for each city for FY 2009-10, the most recent available. In reviewing this supporting documentation and comments provided by each city the CGJ found that all independent audit reports included statements of compliance with auditing standards, including standards of independence.

<sup>4</sup>[http://www.gfoa.org/index.php?option=com\\_content&task=view&id=118&Itemid=130](http://www.gfoa.org/index.php?option=com_content&task=view&id=118&Itemid=130)

Table 16. Competitive Process for Auditor Selection							
Alhambra	Arcadia	Bell	Burbank	Cerritos	Compton	Culver City	Downey
Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Glendale	Industry	Inglewood	Irwindale	Lancaster	Palmdale	Pasadena	Pomona
Yes	No	Yes	No	Yes	Yes	Yes	Yes
Redondo Beach	Santa Monica	Signal Hill	Temple City	Torrance	Vernon	Whittier	
Yes	Yes	Yes	Yes	Yes	Yes	No	

As shown in Table 16, most charter cities (20 yes, 3 no) responded that independent auditors were selected through a competitive process. The CGJ requested each city provide copies of formal policies related to audit procurement. In reviewing this supporting documentation and comments provided by each city, the CGJ found that most issue a Request for Proposals (RFPs) for audit services, typically with a term of up to five years.

Table 17. Auditor Replaced at End of Term							
Alhambra	Arcadia	Bell	Burbank	Cerritos	Compton	Culver City	Downey
No	No	No	No	No	No	No	No
Glendale	Industry	Inglewood	Irwindale	Lancaster	Palmdale	Pasadena	Pomona
Yes	No	No	No	No	No	No	Yes
Redondo Beach	Santa Monica	Signal Hill	Temple City	Torrance	Vernon	Whittier	
Yes	No	No	No	Yes	No	No	

As shown in Table 17, most charter cities (4 yes, 19 no) do not require their auditor to be replaced at the end of the contract term. At the end of the term a new RFP is issued for audit services, with the current auditor allowed to compete for the next audit contract.

Table 18. Non-Audit Services							
Alhambra	Arcadia	Bell	Burbank	Cerritos	Compton	Culver City	Downey
No	Yes	No	Yes	No	No	No	No
Glendale	Industry	Inglewood	Irwindale	Lancaster	Palmdale	Pasadena	Pomona
Yes	No	Yes	No	No	Yes	No	No
Redondo Beach	Santa Monica	Signal Hill	Temple City	Torrance	Vernon	Whittier	
No	Yes	No	No	No	No	No	

As shown in Table 18, most charter cities (6 yes, 17 no) responded that they do not allow the independent auditor to provide non-audit services. Only two of those allowing such non-audit services responded that these services must be approved by the audit committee.

**Accounting Policies and Procedures**

Formal documentation of accounting policies and procedures is an essential component in providing effective controls over accounting and financial reporting, as well as providing a comprehensive framework of internal controls.

Accountability and consistency require a well-designed and maintained system of documenting accounting policies and procedures. This documentation can also provide a useful training tool for financial staff.

The following are excerpts from the GFOA recommended best practice regarding accounting policies and procedures:

Every government should document its accounting policies and procedures. Traditionally, such documentation has taken the form of an accounting policies and procedures manual.

An appropriate level of management to emphasize their importance and authority should promulgate accounting policies and procedures. The documentation of accounting policies and procedures should be evaluated annually and updated periodically, no less than once every three years, according to a predetermined schedule. Changes in policies and procedures that occur between these periodic reviews should be updated in the documentation promptly as they occur. A specific employee should be assigned the duty of overseeing this process. Management is responsible for ensuring that this duty is performed consistently.

The documentation of accounting policies and procedures should be readily available to all employees who need it. It should delineate the authority and responsibility of all employees, especially the authority to authorize transactions and the responsibility for the safekeeping of assets and records. Likewise, the documentation of accounting policies and procedures should indicate which employees are to perform which procedures. Procedures should be described as

they are actually intended to be performed rather than in some idealized form. Also, the documentation of accounting policies and procedures should explain the design and purpose of control related procedures to increase employee understanding of and support for controls.<sup>5</sup>

**Document Accounting Policies/Procedures**

<b>Table 19. Document Accounting Policies/Procedures</b>							
Alhambra	Arcadia	Bell	Burbank	Cerritos	Compton	Culver City	Downey
Yes	Yes	No	No	Yes	Yes	Yes	Yes
Glendale	Industry	Inglewood	Irwindale	Lancaster	Palmdale	Pasadena	Pomona
No	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Redondo Beach	Santa Monica	Signal Hill	Temple City	Torrance	Vernon	Whittier	
No	Yes	Yes	Yes	Yes	Yes	No	

As shown in Table 19, most charter cities (18 yes, 5 no) responded that accounting policies and procedures were formally documented in an accounting policies and procedures manual.

<b>Table 20. Define Authority and Responsibilities</b>							
Alhambra	Arcadia	Bell	Burbank	Cerritos	Compton	Culver City	Downey
Yes	Yes	No	No	Yes	Yes	Yes	Yes
Glendale	Industry	Inglewood	Irwindale	Lancaster	Palmdale	Pasadena	Pomona
Yes	No	Yes	Yes	Yes	Yes	Yes	Yes
Redondo Beach	Santa Monica	Signal Hill	Temple City	Torrance	Vernon	Whittier	
Yes	Yes	Yes	Yes	Yes	Yes	Yes	

As shown in Table 20, most cities (20 yes, 3 no) also responded that accounting policies and procedures specifically define the authority and responsibility of all employees, including the authority to authorize transactions and the responsibility for safekeeping of assets and records.

The CGJ requested each city provide copies of its accounting policies and procedures and accounting manual. In reviewing this supporting documentation and comments provided by each city the CGJ found several cities had very comprehensive and de-

<sup>5</sup> [http://www.gfoa.org/index.php?option=com\\_content&task=view&id=118&Itemid=130](http://www.gfoa.org/index.php?option=com_content&task=view&id=118&Itemid=130)

tailed accounting policies and procedures. These included specific authority and responsibility of employees. Other cities had very high level and brief policies and procedures, with very little detail, and with very little information on the specific authority and responsibility of employees.

Alhambra	Arcadia	Bell	Burbank	Cerritos	Compton	Culver City	Downey
No	No	No response	No	Yes	Yes	Yes	Yes
Glendale	Industry	Inglewood	Irwindale	Lancaster	Palmdale	Pasadena	Pomona
Yes	No response	No response	Yes	No	Yes	No	No
Redondo Beach	Santa Monica	Signal Hill	Temple City	Torrance	Vernon	Whittier	
Yes	No	Yes	No response	Yes	Yes	Yes	

As shown in Table 21, half of the cities (12 yes, 7 no, 4 no response) responded that their accounting policies and procedures were reviewed annually and updated at least once every three years on a predetermined schedule. Upon review of documentation, the CGJ found very little indication that policies and procedures were being reviewed and updated. Most policies and procedures did not include either effective or revision dates, and most of those that did were not within the past three years.

### **Reporting of Fraud, Abuse and Questionable Practices**

Most cases of fraud and abuse, or questionable accounting, or auditing practices, come to the attention of those responsible through employees or members of the public who become aware of these practices and report them.

In addition, accounting and auditing standards require financial reporting systems to be designed to detect not only material fraud or abuse, but also any questionable accounting or auditing practices that could jeopardize the integrity of the financial reporting system.

The following are excerpts from the GFOA recommended best practices regarding reporting of fraud, abuse and questionable practices:

The Government Finance Officers Association recommends that every government establish policies and procedures to encourage and facilitate the reporting of fraud or abuse and questionable accounting or auditing practices. At a minimum, a government should do all of the following:

- Formally approve, and widely distribute and publicize an ethics policy that can serve as a practical basis for identifying potential instances of fraud or abuse and questionable accounting or auditing practices.



- Establish practical mechanisms (e.g., hot line) to permit the confidential, anonymous reporting of concerns about fraud or abuse and questionable accounting or auditing practices to the appropriate responsible parties. A government should regularly publicize the availability of these mechanisms and encourage individuals who may have relevant information to provide it to the government.
- Make internal auditors (or their equivalent) responsible for the mechanisms used to report instances of potential fraud or abuse and questionable accounting or auditing practices. Emphasize that they should take whatever steps are necessary to satisfy themselves that a given complaint is without merit before disposing of it. Further, they also should document the disposition of each complaint received so it can be reviewed by the audit committee.
- Have the audit committee, as part of its evaluation of the government’s internal control framework, examine the documentation of how complaints were handled to satisfy itself that the mechanisms for reporting instances of potential fraud or abuse, and questionable accounting or auditing practices are in place and working satisfactorily.<sup>6</sup>

**Policies and Procedures for Reporting Fraud and Abuse**

Alhambra	Arcadia	Bell	Burbank	Cerritos	Compton	Culver City	Downey
No	No	Yes	No	Yes	Yes	Yes	Yes
Glendale	Industry	Inglewood	Irwindale	Lancaster	Palmdale	Pasadena	Pomona
Yes	No	No	No	Yes	Yes	Yes	Yes
Redondo Beach	Santa Monica	Signal Hill	Temple City	Torrance	Vernon	Whittier	
Yes	No	Yes	No	Yes	Yes	Yes	

As shown in Table 22, most charter cities (15 yes, 8 no) responded that they have policies and procedures to encourage and facilitate the reporting of fraud or abuse and questionable accounting or auditing practices.

<sup>6</sup> [http://www.gfoa.org/index.php?option=com\\_content&task=view&id=118&Itemid=130](http://www.gfoa.org/index.php?option=com_content&task=view&id=118&Itemid=130)

Table 23. Formal and Publicized Ethics Policy							
Alhambra	Arcadia	Bell	Burbank	Cerritos	Compton	Culver City	Downey
Yes	Yes	Yes	No	Yes	Yes	Yes	Yes
Glendale	Industry	Inglewood	Irwindale	Lancaster	Palmdale	Pasadena	Pomona
Yes	No	No	Yes	Yes	No	Yes	Yes
Redondo Beach	Santa Monica	Signal Hill	Temple City	Torrance	Vernon	Whittier	
Yes	No	Yes	Yes	Yes	Yes	Yes	

As shown in Table 23, most cities (18 yes, 5 no) responded that they have a formally adopted and widely distributed and publicized ethics policy.

In reviewing the supporting documentation and comments provided by the cities, the CGJ found several cities had very comprehensive and detailed policies and procedures on reporting fraud, abuse and questionable acts. These included definitions of fraud and abuse, clear responsibilities for employees and management personnel, and guidelines and steps for investigating allegations and reporting the results. Other cities have very limited policies, such as statements that all city employees follow the highest ethical standards, or have adopted specific policies regarding reporting of travel expense reimbursement.

Table 24. Confidential/Anonymous Fraud Reporting							
Alhambra	Arcadia	Bell	Burbank	Cerritos	Compton	Culver City	Downey
No	No	No	No	Yes	No	Yes	Yes
Glendale	Industry	Inglewood	Irwindale	Lancaster	Palmdale	Pasadena	Pomona
Yes	No	No	Yes	Yes	No	No	Yes
Redondo Beach	Santa Monica	Signal Hill	Temple City	Torrance	Vernon	Whittier	
Yes	No	Yes	No	No	Yes	No	

As shown in Table 24, several cities (10 yes, 13 no) responded they have a practical mechanism, such as a fraud hotline, to permit the confidential, anonymous reporting of concerns about fraud, abuse, or questionable practices. However, in review of the documentation and comments the CGJ found only Glendale, actually had an ethics hotline for confidential and anonymous reporting. Other cities stated that employees or members of the public could write a letter to the city with concerns, or that the city had an open door policy and concerns could be taken to supervisors, managers, the city manager, or the city attorney.

## Internal Controls

Internal controls are designed to safeguard city assets from error, loss, theft, misuse, misappropriation, and fraud.

Effective programs of internal controls provide reasonable assurance that these objectives are met continuously and consistently. Internal controls play an important role in preventing and detecting fraud and protecting the organization's resources.

The following are excerpts from the GFOA recommended best practice regarding internal controls:

Internal control procedures over financial management should be documented.

Documented internal control procedures should include some practical means for lower level employees to report instances of management override of controls that could be indicative of fraud.

Financial managers, with the assistance of internal auditors or equivalent personnel as needed, periodically evaluate relevant internal control procedures to satisfy themselves that those procedures 1) are adequately designed to achieve their intended purpose, 2) have actually been implemented, and 3) continue to function as designed.

Evaluations should also encompass the effectiveness and timeliness of the government's response to indications of potential control weaknesses generated by internal control procedures (e.g., resolution of items in exception reports).

Upon completion of any evaluation of internal control procedures financial managers determine what specific actions are necessary to remedy the root cause of any disclosed weaknesses. A corrective action plan with an appropriate timetable should be adopted. There should be follow-up on the corrective action plan to ensure that it has been fully implemented on a timely basis.<sup>7</sup>

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<sup>7</sup> [http://www.gfoa.org/index.php?option=com\\_content&task=view&id=118&Itemid=130](http://www.gfoa.org/index.php?option=com_content&task=view&id=118&Itemid=130)

<b>Table 25. Internal Controls Documented</b>							
Alhambra	Arcadia	Bell	Burbank	Cerritos	Compton	Culver City	Downey
Yes	Yes	No	No	Yes	Yes	Yes	Yes
Glendale	Industry	Inglewood	Irwindale	Lancaster	Palmdale	Pasadena	Pomona
Yes	No	No	Yes	Yes	Yes	Yes	Yes
Redondo Beach	Santa Monica	Signal Hill	Temple City	Torrance	Vernon	Whittier	
Yes	No	Yes	Yes	Yes	Yes	No	

As shown in Table 25, most cities (17 yes, 6 no) responded that internal control procedures over financial management were formally documented. They also responded that internal control procedures include practical means for lower level employees to report instances of management override of controls.

The CGJ requested a copy from each city of the internal control procedures over financial management. In reviewing this documentation, the CGJ found Pasadena and Signal Hill had developed comprehensive procedures for internal control. Pasadena had developed very detailed preventive and detective internal controls and procedural guidelines which included very specific internal control procedures for specific transactions and functions. Signal Hill adopted an internal control procedure that included an overview of internal control procedures, and specific checklists for specific transactions and functions. Other cities provided no specific documentation of internal control procedures, or made minor mention of internal control procedures as part of their financial and accounting policies and procedures.

<b>Table 26. Internal Controls Evaluated</b>							
Alhambra	Arcadia	Bell	Burbank	Cerritos	Compton	Culver City	Downey
Yes	Yes	No	Yes	Yes	Yes	Yes	Yes
Glendale	Industry	Inglewood	Irwindale	Lancaster	Palmdale	Pasadena	Pomona
Yes	No	No	Yes	Yes	Yes	Yes	Yes
Redondo Beach	Santa Monica	Signal Hill	Temple City	Torrance	Vernon	Whittier	
Yes	Yes	Yes	Yes	Yes	Yes	Yes	

As shown in Table 26, most cities (20 yes, 3 no) responded that internal control procedures were evaluated to determine if those controls are adequately designed to achieve their intended purpose, have actually been implemented, and continue to function as designed.

Table 27. Control Weakness Documented							
Alhambra	Arcadia	Bell	Burbank	Cerritos	Compton	Culver City	Downey
Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Glendale	Industry	Inglewood	Irwindale	Lancaster	Palmdale	Pasadena	Pomona
No	No	Yes	Yes	Yes	Yes	Yes	Yes
Redondo Beach	Santa Monica	Signal Hill	Temple City	Torrance	Vernon	Whittier	
Yes	Yes	Yes	Yes	Yes	Yes	Yes	

As shown in Table 27, most cities (21 yes, 2 no) responded that potential internal control weaknesses were documented in their exception reports.

Table 28. Control Weakness Corrective Action Required							
Alhambra	Arcadia	Bell	Burbank	Cerritos	Compton	Culver City	Downey
Yes	No	Yes	No	Yes	Yes	Yes	Yes
Glendale	Industry	Inglewood	Irwindale	Lancaster	Palmdale	Pasadena	Pomona
Yes	No	No	Yes	No	Yes	Yes	Yes
Redondo Beach	Santa Monica	Signal Hill	Temple City	Torrance	Vernon	Whittier	
Yes	Yes	Yes	Yes	Yes	Yes	No	

As shown in Table 28, most cities (17 yes, 6 no) responded that there is a process in place to identify changes in what is being controlled, or the controls themselves. Corrective action plans were developed with appropriate timelines. In reviewing the comments and documentation, it appears that most cities rely primarily on the internal controls review conducted by their independent auditors as part of their annual financial audits.

Based on government auditing standards, independent auditors consider a city's internal controls over financial reporting, and conduct tests of compliance. This review is focused on financial reporting, and not on the larger internal controls environment. Independent auditors generally do not provide an opinion on the internal control over financial reporting or on compliance. Internal controls that ensure there are adequate control procedures in place to protect public funds are the responsibility of city financial management.

### Internal Audit

The internal audit function serves as an additional level of control to improve a city's overall control and risk environment. This includes monitoring the design and proper functioning of the internal control policies and procedures. It is important that the inter-

nal audit function be separate from those that are directly responsible for performing financial functions.

The following are excerpts from the GFOA recommended best practice regarding internal audit:

Every government should consider the feasibility of establishing a formal internal audit function because such a function can play an important role in helping management to maintain a comprehensive framework of internal controls. As a rule, a formal internal audit function is particularly valuable for those activities involving a high degree of risk (e.g., complex accounting systems, contracts with outside parties, a rapidly changing environment). If it is not feasible to establish a separate internal audit function, a government is encouraged to consider either 1) assigning internal audit responsibilities to its regular employees or 2) obtaining the services of an accounting firm (other than the independent auditor) for this purpose;

The internal audit function should be established formally by charter, enabling resolution, or other appropriate legal means;

It is recommended that internal auditors of state and local governments conduct their work in accordance with the professional standards relevant to internal auditing contained in the U.S. General Accounting Office's publication Government Auditing Standards, including those applicable to the independence of internal auditors;

At a minimum, the head of the internal audit function should possess a college degree and appropriate relevant experience. It also is highly desirable that the head of the internal audit function hold some appropriate form of professional certification (e.g., certified internal auditor, certified public accountant, certified information systems auditor); and

All reports of internal auditors, as well as the annual internal audit work plan, should be made available to the government's audit committee or its equivalent.<sup>8</sup>

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<sup>8</sup> [http://www.gfoa.org/index.php?option=com\\_content&task=view&id=118&Itemid=130](http://www.gfoa.org/index.php?option=com_content&task=view&id=118&Itemid=130)

Table 29. Formal Internal Audit Function							
Alhambra	Arcadia	Bell	Burbank	Cerritos	Compton	Culver City	Downey
No	No	No	Yes	No	No	Yes	Yes
Glendale	Industry	Inglewood	Irwindale	Lancaster	Palmdale	Pasadena	Pomona
Yes	No	No	No	Yes	No	Yes	No
Redondo Beach	Santa Monica	Signal Hill	Temple City	Torrance	Vernon	Whittier	
Yes	No	Yes	No	Yes	Yes	No	

As shown in Table 29, most charter cities (10 yes, 13 no) responded that they do not have an internal audit function formally established by charter, enabling resolution, or other legal means. The CGJ found many cities did not provide any documentation of their formal internal audit function. Some cities stated that internal audit was an additional responsibility of their finance staff.

Several cities stated that, given the small size of their city, an internal audit function and staff could not be justified. One city previously had a formal internal audit function; however, the internal audit position had been eliminated due to budget constraints. The duties of the internal auditor were reassigned to the finance director and controller.

**General Fund Unrestricted Fund Balance**

The term “fund balance” is used to describe the net assets of governmental funds, and is intended to provide a measure of the financial resources available in the fund. Some of this fund balance is typically restricted because it is not available (for legal or contractual reasons), or restricted by external constraints.

Unrestricted funds include those that are unassigned, as well as those that are committed or assigned by the city council. The city council would be able to change these commitments or assignments if deemed necessary.

It is important that governments formally set aside adequate funds for use in emergencies, revenue shortages, or budget imbalances. Adequate fund balances are also important to provide stable tax rates, maintain government services, and to facilitate long-term financial planning.

The following are excerpts from the GFOA recommended best practice regarding general fund unrestricted fund balance:

The Government Finance Officers Association (GFOA) recommends that governments establish a formal policy on the level of unrestricted fund balance that should be maintained in the general fund.

Such a guideline should be set by the appropriate policy body and should provide both a temporal framework and specific plans for increasing or decreasing the

level of unrestricted fund balance, if it is inconsistent with that policy. The adequacy of unrestricted fund balance in the general fund should be assessed based upon a government’s own specific circumstances. Nevertheless, GFOA recommends, at a minimum, that general-purpose governments, regardless of size, maintain unrestricted fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures.<sup>9</sup>

Table 30. Policy of Unrestricted Fund Balance							
Alhambra	Arcadia	Bell	Burbank	Cerritos	Compton	Culver City	Downey
Yes	No	No	Yes	No	Yes	Yes	No
Glendale	Industry	Inglewood	Irwindale	Lancaster	Palmdale	Pasadena	Pomona
Yes	No	Yes	Yes	Yes	Yes	Yes	Yes
Redondo Beach	Santa Monica	Signal Hill	Temple City	Torrance	Vernon	Whittier	
Yes	Yes	Yes	No	No	Yes	No	

As shown in Table 30, most charter cities (15 yes, 8 no) responded that they have a formal policy on the level of unrestricted fund balance to be maintained in the general fund.

Table 31. Require Two Months Unrestricted Fund Balance							
Alhambra	Arcadia	Bell	Burbank	Cerritos	Compton	Culver City	Downey
No	No	No	Yes	No Response	No	Yes	No Response
Glendale	Industry	Inglewood	Irwindale	Lancaster	Palmdale	Pasadena	Pomona
No	No	Yes	Yes	No	Yes	Yes	No
Redondo Beach	Santa Monica	Signal Hill	Temple City	Torrance	Vernon	Whittier	
No	Yes	Yes	No	No Response	No	No	

As shown in Table 31, most charter cities (7 yes, 13 no, 3 no response) responded that they do not have a policy requiring an unrestricted fund balance spanning no less than two months of regular general fund operating revenues or regular general fund operating expenditures.

<sup>9</sup> [http://www.gfoa.org/index.php?option=com\\_content&task=view&id=118&Itemid=130](http://www.gfoa.org/index.php?option=com_content&task=view&id=118&Itemid=130)



**Financial and Public Reporting Practices**

Financial statements and information prepared and provided by each city give members of the public information concerning how their city is expending its resources, as well as the financial stability and health of the city.

Ensuring the transparency and reliability of financial reporting is a key responsibility of financial management within each city. This requires maintaining an adequate financial accounting system and issuing financial statements in a timely manner.

The following are excerpts from the GFOA recommended best practice regarding financial and public reporting practices:

Maintain an accounting system adequate to provide all of the data needed to allow for the timely preparation of financial statements for the entire financial reporting entity in conformity with GAAP;

Issue timely financial statements for the entire financial reporting entity in conformity with GAAP as part of a CAFR; and

Have those financial statements independently audited in accordance with either GAAS or GAS, as appropriate.

The GFOA encourages every government to use its web site as a primary means of communicating financial information to citizens and other interested parties.<sup>10</sup>

**Adequate Accounting System**

Table 32. Adequate Accounting System							
Alhambra	Arcadia	Bell	Burbank	Cerritos	Compton	Culver City	Downey
Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Glendale	Industry	Inglewood	Irwindale	Lancaster	Palmdale	Pasadena	Pomona
Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Redondo Beach	Santa Monica	Signal Hill	Temple City	Torrance	Vernon	Whittier	
Yes	Yes	Yes	Yes	Yes	Yes	Yes	

As shown in Table 32, all charter cities (23 yes, 0 no) responded that they maintain an accounting system adequate to provide all the data needed for the timely preparation of financial statements in conformity with Generally Accepted Accounting Principles (GAAP).

<sup>10</sup> [http://www.gfoa.org/index.php?option=com\\_content&task=view&id=118&Itemid=130](http://www.gfoa.org/index.php?option=com_content&task=view&id=118&Itemid=130)

<b>Table 33. Timely Financial Statements (GAAP)</b>							
Alhambra	Arcadia	Bell	Burbank	Cerritos	Compton	Culver City	Downey
Yes	Yes	No	Yes	Yes	Yes	Yes	Yes
Glendale	Industry	Inglewood	Irwindale	Lancaster	Palmdale	Pasadena	Pomona
Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Redondo Beach	Santa Monica	Signal Hill	Temple City	Torrance	Vernon	Whittier	
Yes	Yes	Yes	Yes	Yes	Yes	Yes	

As shown in Table 33, all but one city (22 yes, 1 no) responded that they issue timely financial statements in conformity with standards as part of a CAFR. The City of Bell has not yet issued financial statements for FY 2009-10, and reports it is in the process of preparing these statements with an independent auditor.

<b>Table 34. CAFR Readily Available on the Public or City Website</b>							
Alhambra	Arcadia	Bell	Burbank	Cerritos	Compton	Culver City	Downey
Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Glendale	Industry	Inglewood	Irwindale	Lancaster	Palmdale	Pasadena	Pomona
Yes	No	Yes	Yes	Yes	Yes	Yes	Yes
Redondo Beach	Santa Monica	Signal Hill	Temple City	Torrance	Vernon	Whittier	
Yes	Yes	Yes	Yes	Yes	Yes	Yes	

As shown in Table 34, all but one city (22 yes, 1 no) responded that their financial statements or CAFR were readily available on their city’s website.

In reviewing the supporting documentation and comments provided by the cities the CGJ found that Compton, Industry, Inglewood, and Temple City did not issue CAFRs for FY 2009-10. These cities issued basic financial statements, some with management’s discussion and analysis and others without analysis. The CGJ also found that Compton, Industry, and Temple City did not provide their financial reports on their city’s website as of December, 2011.

## **FINDINGS – FINANCIAL MANAGEMENT PRACTICES**

1. All charter cities formally established an audit committee responsible for monitoring and overseeing financial reporting.
2. All charter cities required their auditors to comply with independence standards and most selected their auditors through a competitive process. Most also precluded the auditor from providing non-audit services.
3. Most cities could improve their documentation and maintenance of accounting policies and procedures.
4. Most cities could improve their policies and procedures for reporting fraud, abuse, and questionable practices.
5. Most cities could improve their internal control procedures over financial management.
6. Most charter cities did not have a formal internal audit function.
7. Many charter cities' policies and procedures governing general fund unrestricted fund balance could be improved.
8. All cities maintained an adequate accounting system. Most issued timely financial statements and a CAFR in compliance with standards, and most made the CAFR readily accessible to the general public on their website.

## **BEST PRACTICES**

1. All charter cities should formally establish an audit committee making it directly responsible for the work of the independent auditor.
2. All charter cities should continue requiring compliance with standards of independence for the external auditor. Cities that do not currently select the auditor through a competitive process should do so. Cities that allow the auditor to provide non-audit services should ensure appropriate review and approval of those services.
3. All charter cities should review and update accounting policies and procedures to ensure they are appropriately detailed and define the specific authority and responsibility of employees. Cities should also establish a policy requiring policies and procedures to be reviewed annually and updated at least once every three years.
4. All charter cities should review and update policies and procedures for reporting fraud, abuse and questionable practices including a practical mechanism, such as a fraud hotline, to permit the confidential, anonymous reporting of concerns.
5. All charter cities should periodically review and update internal control procedures over financial management.

6. All charter cities that have not adopted a policy requiring an unrestricted fund balance of no less than two months of regular general fund operating revenues or regular general fund operating expenditures should develop such policies.
7. Charter cities must develop and publish a timely Comprehensive Annual Financial Report (CAFR).
8. Charter cities should publish financial reports on their city's website.

## **PROCUREMENT AND CONTRACTING PRACTICES**

The costs of goods and services acquired by procurement and contracting are a substantial expenditure of city resources. These expenditures are generally second only to the expenditures for employee salaries and benefits. Developing and maintaining adequate policies and procedures for procurement and contracting are important to ensure city resources are protected, and goods and services are procured in the best interest of the city. These policies include competitive bidding requirements, procuring professional services such as architectural and engineering, negotiating prices and change orders, and providing contract oversight and compliance.

### **Competitive Bidding Requirements and Practices**

The California Public Contract Code §100 defines the requirements for public contracting for public entities. The objectives of this Code are:

- To clarify the law with respect to competitive bidding requirements.
- To ensure full compliance with competitive bidding statutes as a means of protecting the public from misuse of public funds.
- To provide all qualified bidders with a fair opportunity to enter the bidding process, thereby stimulating competition in a manner conducive to sound fiscal practices.
- To eliminate favoritism, fraud, and corruption in the awarding of public contracts.

This Code also specifically allows charter cities an exemption as stated in Section §1100.7

This code is the basis of contracts between most public entities in this state and their contractors and subcontractors. With regard to charter cities, this code applies in the absence of an express exemption or a city charter provision or ordinance that conflicts with the relevant provision of this code.

Given the authority granted under this section, it is important that charter cities formally adopt policies and procedures defining competitive bidding.

Table 35. Formal Competitive Bidding Process							
Alhambra	Arcadia	Bell	Burbank	Cerritos	Compton	Culver City	Downey
Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Glendale	Industry	Inglewood	Irwindale	Lancaster	Palmdale	Pasadena	Pomona
Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Redondo Beach	Santa Monica	Signal Hill	Temple City	Torrance	Vernon	Whittier	
Yes	Yes	Yes	Yes	Yes	Yes	Yes	

As shown in Table 35, all cities (23 yes, 0 no) responded that their city has formally adopted policies and procedures defining competitive bidding requirements and practices for the procurement of goods and services. The CGJ asked cities to provide copies of the city charter or city ordinance providing exemption from competitive procurement requirements of California’s Public Contract Code (CPCC). In reviewing this information the CGJ found all cities had such formally adopted policies.

Table 36. Exemption from Competitive Procurement							
Alhambra	Arcadia	Bell	Burbank	Cerritos	Compton	Culver City	Downey
Yes	<b>No</b>	Yes	Yes	Yes	Yes	Yes	Yes
Glendale	Industry	Inglewood	Irwindale	Lancaster	Palmdale	Pasadena	Pomona
Yes	Yes	Yes	<b>No</b>	Yes	Yes	<b>No</b>	<b>No</b>
Redondo Beach	Santa Monica	Signal Hill	Temple City	Torrance	Vernon	Whittier	
Yes	Yes	Yes	<b>No</b>	Yes	Yes	<b>No</b>	

As shown in Table 36, most cities (17 yes, 6 no) responded that their city charter or city ordinance provide exemption from competitive procurement requirements of CPCC. The CGJ asked cities to provide the formal policy defining competitive bidding requirements and practices for the procurement of goods and services. The CGJ found that most cities had exemptions from competitive bidding for emergencies, or when items were only available from one source, i.e. sole source contracting.

<b>Table 37. Formal Policies - Sole Source Contracting</b>							
Alhambra	Arcadia	Bell	Burbank	Cerritos	Compton	Culver City	Downey
Yes	Yes	No	Yes	Yes	Yes	Yes	Yes
Glendale	Industry	Inglewood	Irwindale	Lancaster	Palmdale	Pasadena	Pomona
Yes	No	Yes	No	Yes	Yes	Yes	Yes
Redondo Beach	Santa Monica	Signal Hill	Temple City	Torrance	Vernon	Whittier	
Yes	Yes	Yes	No	Yes	Yes	Yes	

As shown in Table 37, most of the cities (19 yes, 4 no) responded that they had formally adopted policies and procedures establishing internal controls over sole-source contracting. The CGJ asked cities to provide copies of the formal policy establishing internal controls over sole source contracting. The CGJ found that those cities with such controls, required formal review and approval of sole source contracts by either the city manager or city council, or both.

**Procuring Architectural and Engineering Services**

California Government Code §4526, which requires that the general law cities select private firms for professional services of architectural, landscape architectural, engineering, environment, land surveying or construction project management by local agencies, be based on demonstrated competence and professional qualifications. This section has been interpreted by many public entities to require firms be initially selected on qualifications alone, precluding consideration of price in the selection. These procedures specifically prohibit policies which might result in unlawful activity including rebates, kickbacks, and government agency employees participating in seeking contracts.

California Government Code §4528 further requires that the local general law agency negotiate a contract with the best qualified firm with a price that is determined to be fair and reasonable. If a fair and reasonable price cannot be negotiated with the firm considered to be the most qualified, negotiations with that firm are terminated and negotiations with the second most qualified firm initiated. This continues until a fair and reasonable price is negotiated.

A best practice used by many governmental agencies to establish fair and reasonable compensation is to perform contract pre-award cost reviews of proposed fully burdened labor rates as a basis for negotiating fair and reasonable fees. Use of pre-award audits to establish fair and reasonable fees could and often does result in significant cost savings unavailable to general law cities.

Alhambra	Arcadia	Bell	Burbank	Cerritos	Compton	Culver City	Downey
Yes	No	No	Yes	No	Yes	Yes	Yes
Glendale	Industry	Inglewood	Irwindale	Lancaster	Palmdale	Pasadena	Pomona
Yes	No	No	No	Yes	Yes	No	Yes
Redondo Beach	Santa Monica	Signal Hill	Temple City	Torrance	Vernon	Whittier	
Yes	Yes	Yes	Yes	Yes	Yes	No	

As shown in Table 38, most cities (15 yes, 8 no) responded that they had formally adopted policies and procedures for selecting firms that provide architectural and engineering services. The CGJ requested cities provide copies of their formally adopted policies and procedures for selecting firms that provide architectural and engineering services. The CGJ found only a few cities whose policies and procedures were consistent with the above sections of California Government Code §4528.

Burbank and Pomona have policies that provide for a negotiated proposal process where the most qualified is identified and the fee and payment schedule is negotiated. Several cities have specific policies and procedures for selecting architectural and engineering services. However, these include consideration of price in the initial selection contrary to the state code.

Since competitive bidding cannot be used in the selection of architectural and engineering services, it is important that negotiated prices are fair and reasonable.



Alhambra	Arcadia	Bell	Burbank	Cerritos	Compton	Culver City	Downey
Yes	No	No	Yes	No	Yes	Yes	Yes
Glendale	Industry	Inglewood	Irwindale	Lancaster	Palmdale	Pasadena	Pomona
Yes	No	No	No	Yes	Yes	No	No
Redondo Beach	Santa Monica	Signal Hill	Temple City	Torrance	Vernon	Whittier	
Yes	Yes	Yes	Yes	No	Yes	No	

As shown in Table 39, more than half of the cities (13 yes, 10 no) responded that they had formally adopted policies and procedures for ensuring that prices for negotiated contracts are fair and reasonable. The CGJ requested cities provide copies of the formally adopted policies and procedures for ensuring that prices for negotiated contracts are fair and reasonable. In reviewing this information the CGJ found only a few cities actually had such policies and procedures. Most continued to rely on a competitive pricing approach for these services.

### **Negotiated Prices and Contract Change Orders**

Cities generally issue construction contracts through a competitive bidding process by which the reasonableness of bid prices are established. However, construction contracts commonly require contract change orders due to unforeseen conditions during construction or changes in architectural and/or engineering design. These contract change orders should be competitively bid, rather than awarded to the same firm that was awarded the original contract. If substantial contract change orders are not competitively bid, the cities must take other steps to ensure the proposed cost of these changes orders is fair and reasonable.

Best practices for contract change order pricing include the following:

- Preparation of an independent estimate of change order cost.
- A contractor detailed cost proposal.
- A price or cost analysis of the contractor’s proposal.
- Preparation of a record of negotiation showing the basis for reaching a fair and reasonable price.

<b>Table 40. Formal Policies - Fair Change Order Pricing</b>							
Alhambra	Arcadia	Bell	Burbank	Cerritos	Compton	Culver City	Downey
No	No	No	No response	No	Yes	Yes	Yes
Glendale	Industry	Inglewood	Irwindale	Lancaster	Palmdale	Pasadena	Pomona
Yes	No	No	Yes	Yes	Yes	No	No
Redondo Beach	Santa Monica	Signal Hill	Temple City	Torrance	Vernon	Whittier	
Yes	Yes	Yes	Yes	No	Yes	No	

As shown in Table 40, half of the cities (12 yes, 10 no, 1 no response) responded that they had formally adopted policies and procedures for ensuring that prices negotiated for contract change orders are fair and reasonable.

<b>Table 41. Formal Policies – Internal Controls- Change Orders</b>							
Alhambra	Arcadia	Bell	Burbank	Cerritos	Compton	Culver City	Downey
No	Yes	No	Yes	No	Yes	Yes	Yes
Glendale	Industry	Inglewood	Irwindale	Lancaster	Palmdale	Pasadena	Pomona
Yes	Yes	No	No	No	Yes	Yes	Yes
Redondo Beach	Santa Monica	Signal Hill	Temple City	Torrance	Vernon	Whittier	
Yes	Yes	Yes	No	No	Yes	No	

As shown in Table 41, most cities (14 yes, 9 no) responded that they had formally adopted policies and procedures establishing internal controls over contract change orders. The CGJ requested cities provide copies of their formally adopted policies and procedures establishing internal controls over contract change orders. The CGJ found several cities had comprehensive controls over change orders, with specific limits on change order amounts and detailed approval steps. The CGJ did not find any cities that had formal policies to ensure fair pricing on change orders.

**Procurement and Contracting Compliance and Oversight**

Documentation of the procurement process is necessary in order to ensure compliance with the procurement requirements. Contract compliance and oversight are also important to ensure that contractors are providing the goods or services they are paid for within the terms provided by the contract.