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IN THE SHADOW OF CORPORATE SCANDAL: THE USE OF AUDIT COMMITTEES IN U.S. LOCAL GOVERNMENTS

David S. T. Matkin*

ABSTRACT. Recent financial scandals in the private sector have led to widespread speculation that public organizations may be susceptible to similar events of financial misconduct and should, therefore, be required to adopt similar strategies to those that are mandated of private-sector corporations under the Sarbanes-Oxley Act of 2002. This paper looks at one of those strategies by examining the use of audit committees in U.S. local governments. Specifically, this paper explores (1) why local governments have heretofore voluntarily created audit committees, (2) the perceived benefits and problems of audit committees, and (3) whether the use of audit committees is compatible with the principal-agent logic that underlies their promotion.

INTRODUCTION

The financial collapse of energy-giant Enron and the subsequent fall of its previously respected accounting firm, Arthur-Andersen, led to widespread concern that established accounting and auditing practices may be insufficient to prevent destructive events of financial fraud and mismanagement in the private sector. In an attempt to mitigate these concerns, the U.S. Congress enacted the controversial Sarbanes-Oxley Act of 2002. Many observers have subsequently speculated that the financial systems of government and not-for-profits are similarly flawed and are thereby susceptible to similar events of financial misconduct. Some have pointed to the Sarbanes-Oxley Act as a model regulation that should be replicated in

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* *David S. T. Matkin, Ph.D., is an Assistant Professor, Reubin O'D. Askew School of Public Administration & Policy, Florida State University. His research and teaching interests are in public management and public budgeting and financial management.*

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the public sector to prevent such a debacle (Candreva, 2006; Harris, 2005; Brown, 2005; Jackson & Fogarty, 2005).

Though the Sarbanes-Oxley Act (SOX) is often discussed as though it is a single policy, in fact, it includes several distinct components. For example, SOX increases penalties against corporate executives who knowingly and willfully misstate financial statements; it provides whistleblower protections for employees who report corporate fraud; it requires corporate executives to certify their company's financial statements and to evaluate and report on the effectiveness of their internal controls; and, it mandates the creation of independent and fully-funded audit committees.

Because SOX is composed of so many different components, it is wise to assess each one before imposing the whole act upon public organizations. This paper is an examination of one of those components within the public sector—the use of audit committees in U.S. local governments.

Audit committees and similar financial-oversight committees are already widely used by U.S. local governments—nearly 50 percent already have an audit committee (West & Berman, 2002). Despite their relatively common use, little is known about these committees. This paper draws on a national survey of local government officials in U.S. cities and counties to examine the current use of audit committees in local governments. Using that data, this paper provides preliminary answers to three questions: (1) why do local governments create audit committees, (2) what are the perceived benefits and problems with audit committees, and (3) is the principal-agent logic that underlies the popular promotion of audit committees compatible with the current use of audit committees?

This paper proceeds as follows. The next section provides a brief introduction to audit committees. It is followed by a discussion of the paper's research questions. Then, the research methods are described, followed by the findings. The paper concludes with a discussion of the practical and theoretical implications of the findings.

INTRODUCTION TO AUDIT COMMITTEES

Audit committees are groups of individuals who represent the interests of their organization's governing body and are responsible

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for strengthening the organization's internal controls and for ensuring the accuracy of the organization's financial reports. Audit committees perform these functions by "ensuring that the whole subject of internal control and financial reporting periodically appears on the governing body's radar screen and is dealt with in a timely and appropriate manner" (Gauthier 2006, p. 13). Audit committees are extensions of their governing bodies and often include individuals from the governing body in their membership, but they do not set policy or manage administrative units.

The rationale behind the need for audit committees is based on a concern that principal-agent problems are inherent in the management of financial resources (Brehm and Gates 1999). Governing bodies (e.g., city councils) are thought to be unable to provide adequate oversight of their organizations' financial systems due to unavoidable limitations in their time, attention, and technical expertise. Relaxed oversight is potentially problematic because financial activities are technically complex, and self-interested financial managers could take advantage of that complexity to prevent their governing bodies from detecting events of financial mismanagement or fraud. Relaxed oversight may also be problematic if interested stakeholders, such as grantors, business investors, or bond investors are less confident in the accuracy of the organization's financial reports or in the organization's ability to prevent financial mismanagement or fraud. If interested stakeholders perceive an organization to be at higher risk of financial misconduct, they may require a premium to work with or invest in the organization.

One way governing bodies respond to this problem is by contracting with external auditors to conduct annual audits of their financial reports and internal controls. Unfortunately, governing bodies also face principal-agent problems in the selection and monitoring of external auditors, especially since finance directors are often key participants in the selection and monitoring of external auditors.

Audit committees are viewed as a way to mitigate these principal-agent problems by increasing the oversight of financial management activities—the so-called monitoring function of accounting systems—and by ensuring the accuracy of financial auditing and reporting—the so-called signaling function of accounting systems (Evans & Patton 1987). Audit committees perform these functions by monitoring the

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integrity of their organization's financial systems and by participating in the selection of an organization's external auditor to ensure that the auditor is qualified and independent.

Corporate Origins

Although they are relatively new to the public sector, audit committees have been part of corporate governance for nearly a century. In 1940, the six-year-old Securities and Exchange Commission recommended that all publicly-traded corporations create an audit committee. In 1977, the New York Stock Exchange required its listed companies to establish audit committees and other security exchanges followed their lead—the National Association of Securities Dealers in 1987 and the American Stock Exchange in 1993.

Though corporate audit committees were relatively common by the early 1990s, interested observers speculated that these committees were often insufficiently designed to effectively limit fraudulent activity—in part because the committees tended to meet infrequently and their members often lacked sufficient financial expertise and were frequently corporate insiders with significant conflicts of interest (National Commission on Fraudulent Financial Reporting, 1987). For example, the Blue Ribbon Committee on Improving the Effectiveness of Corporate Auditing Committees (1999) found that too many individuals were serving on audit committees for the primary purpose of improving their chances of eventually obtaining a position on the corporation's board of directors.

Subsequent research supports the Blue Ribbon Committee's concern for the importance of audit committee membership. Klein (2002) found a relationship between the membership composition of corporate audit committees and events of earnings manipulation. Incidents of earnings manipulation increase when a majority of audit committee members have a financial interest in the organization. Krishnan (2005) found that the independence and financial expertise of audit committee members was associated with fewer incidences of internal control problems on audit reports.

In order to correct perceived deficiencies in the independence and financial expertise of audit committees, the Sarbanes-Oxley Act of 2002 mandates that all publicly-traded corporations create an

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audit committee and ensure that their committees are fully funded, perform a central role in the auditing process, and have a membership that is independent from the managerial interests of the corporation (SOX, 2002). The focus of these requirements is oriented toward mitigating principal-agent problems in financial oversight and reporting.

Recommended Practice in State and Local Government

In 1997, the Governmental Finance Officers Association (GFOA) issued the first recommended practice on the use of audit committees for state and local governments. The GFOA revised their recommendation in 2002, the same year that the Sarbanes-Oxley Act was enacted, and again in 2006. Their most recent revision was primarily influenced by "substantial changes [that took] place in private audit committee practice" (Gauthier, 2006, p. ix)—especially as a result of the Sarbanes-Oxley Act, Security and Exchange Commission regulations and the 1999 Report of the New York Stock Exchange's Special Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees (Gauthier, 2006, p. ix). Not surprisingly, therefore, the GFOA's current recommended practice on audit committees is similar to the required practice for corporate audit committees under the Sarbanes-Oxley Act and shares its focus of mitigating principal-agent problems in financial oversight and reporting (Government Financial Officers Association, 2006).

Actual Practice in Local Government

Audit committees are now widely used in U.S. local governments—nearly 50 percent of local governments have an audit committee (West & Berman, 2002). However, the structures and practices of these committees are substantially different from the GFOA's recommended practices.

The GFOA, for example, recommends that audit committee membership be composed entirely of elected officials and recommends excluding administrative staff from committee membership. However, West and Berman (2007, p. 338) found that 12.4 percent of their surveyed local governments do not allow elected officials to serve as members of their audit committee, and 42.5 percent include their finance director or comptroller as a member of the committee, and the city manager or other chief-appointed

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administrator is a committee member in 27.4 percent of local governments.

The GFOA also recommends that audit committees should serve as the central connection between the external auditor and the governing body. However, West and Berman (2007) find that fewer than 50 percent of audit committees are involved in guiding the independent auditor's level of responsibility or in examining the audit plan.

The GFOA also recommends that audit committees perform a central role in financial oversight and internal controls. However, West and Berman (2007, p. 344) report that nearly 30 percent of audit committees are not informed of unusual financial transactions within their government—such as "related party transactions," "illegal activities" and "all instances of fraud."

Given that the GFOA's recommended practices on audit committees is relatively new, it is perhaps not surprising that there is a notable disparity between their recommendations and the actual use of audit committees in U.S. local governments. Many local governments are likely to have created their audit committees well before the GFOA published their first recommended practice on the subject. If improved independence and financial expertise are truly the goals of local government audit committees, it is logical that the disparity between recommended and actual practices will decrease over time as local government officials understand the benefits of the GFOA's recommendations. It is also possible, however, that the disparity between recommended and actual practices may indicate that principal-agent problems are only part of the reason for the adoption of audit committees in local government. If audit committees achieve other objectives, local government officials may be satisfied with less independence and/or less expertise in these committees. So that the reader can better understand the use of audit committees in local governments and the disparity between recommended and actual practices, three questions are asked.

RESEARCH QUESTIONS

The first question is "Why do local governments create audit committees?" This question is exploratory. It is answered by identifying common reasons why local governments have voluntarily

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created audit committees and by identifying why other local governments have chosen not to create audit committees.

The second research question is “What are the perceived benefits and problems with the use of audit committees in local government?” This question is also exploratory. It is answered by identifying commonly perceived benefits and problems of audit committees. Care is taken to distinguish between the perceptions of public officials who are more experienced with audit committees—so-called expert opinions—versus perceptions from those officials that have less direct experience with audit committees.

The third research question applies information from the answers to the first two research questions to assess the underlying logic of audit committees. The third question asks “Is the principal-agent logic that underlies the promotion of audit committees compatible with the actual use of these committees?” The principal-agent logic behind audit committees suggests that governments are most likely to create audit committees in order to deal with financial control problems such as events of fraud or mismanagement or in situations when interested stakeholders lack confidence in the integrity of a government’s financial reports and practices. The principal-agent approach also suggests that local governments are likely to view the benefits and problems of audit committees in terms of their ability, or inability, to prevent events of financial mismanagement and fraud or to improve confidence in financial reporting.

RESEARCH METHODS

Sample

In order to examine the use of audit committees, officials from 195 local governments in 42 different states were contacted and asked about their government’s experience with audit committees or similar financial oversight committees. (Details on how the 195 local governments were selected are discussed in Note 1). A researcher contacted each local government’s finance department and introduced the study to the finance director. The researcher then asked the finance director for consent to talk with an individual within the government who is most knowledgeable about their government’s use of financial-oversight committees. In a few situations, the

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researcher was referred to a more knowledgeable contact but most of the interviews were completed with the finance directors.

Of the 195 local governments contacted, semi-structured interviews were completed with 136 officials (a response rate of 69.74 percent). Four attempts were made to contact each local government over a three-week period in November and December 2007.

Of the responding governments, 50 (36.8 percent) currently have an audit committee, or similar financial oversight committee; 11 (8.1 percent) recently had an audit committee, but the committee is now dissolved; 15 (11.0 percent) have considered creating an audit committee in the past five years but do not currently have one; and, 60 (44.1 percent) do not have a committee, have never had one, and have never considered creating one.

Twenty-nine jurisdictions did not complete an interview—only four declined to be interviewed. A review of the 29 governments that did not complete an interview reveals no evidence of response bias based on jurisdictional size or geographic location.

Survey

Interview questions were designed to gather information that is necessary to answer the research questions. Government officials were asked different interview questions, based on their government's experience with audit committees. Table 1 lists the areas of information that were pursued by the interviewer depending on their government's level of experience with audit committees.

TABLE 1
Interview Structure

Audit committee status in respondent's local government	Information gathered in the interview
Currently has an audit committee	- Circumstances that preceded the committee's creation - Influential stakeholders (both for and against the committee's creation) - Challenges and successes of the audit committee - General observations about audit committees

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TABLE 1 (Continued)

Audit committee status in respondent's local government	Information gathered in the interview
Previously had an audit committee	- Circumstances that preceded the committee's creation - Influential stakeholders (both for and against the committee's creation) - Challenges and successes of the audit committee - Circumstances that led to the committee's removal
Has considered creating an audit committee	- Circumstances that initiated the committee's consideration - Influential stakeholders (both for and against the committee's creation) - Circumstances that led to the decision not to create a committee (if the decision has been made)
Never had an audit committee and has never considered creating an audit committee	- Level of knowledge regarding audit committees - Circumstances that may suggest a need for increased financial oversight or improved financial reporting - General observations about audit committees

To strengthen convergent validity, a variety of prompts were used to gather the information used to answer each question. Interview prompts are listed in Table 2. The prompts were used to help the interviewers organize their questions but the prompts were not always asked exactly as written in Table 2. Interviews were usually completed in ten to fifteen minutes.

Analysis

The interviewers took structured notes during each interview. To strengthen the reliability of the analysis, four raters, including the original interviewer, analyzed each interview. The raters identified observations that were relevant to the research questions.

To answer the first research question, the researchers identified interviewee statements that provided information on (1) sources of support or resistance to the creation of audit committees, (2) relevant events that occurred prior to the creation of audit committees, (3) issues that were considered in the creation of audit committees, (4)

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TABLE 2
Interview Prompts

Information gathered in the interview	Prompts
Circumstances that preceded the committee's creation	- "Why was the committee created?" - "Where did the idea come from?" - "When was it created?" - "Where there any financial problems in the city around the time the committee was created?" - "Was this the first time the government ever discussed creating an audit committee?" - "Was the committee discussed in response to an event?" - "Was the committee discussed in preparation for an event?"
Circumstances that initiated the committee's consideration	- Similar to the questions above.
Circumstances that suggested the need for increased financial oversight or improved financial reporting	- Similar to the questions above.
Influential stakeholders in the committee's creation	- "Who championed its creation?" - "Where there sources outside of the government that recommended its creation?"
Influential stakeholders in the committee's consideration	- Similar to the questions above.
Challenges and successes of the audit committee	- "Is it difficult to maintain membership?" - "Is it difficult to obtain participation from elected officials?" - "Are there unexpected difficulties that affect the committee's performance of its duties?" - "Are there political challenges?" - "Are there administrative challenges?" - "Have you noticed any positive response from stakeholders?" - "How have financial practices been affected?"
Circumstances that led to the committee's removal	- Similar to questions above. - "Did a different strategy take the place of the audit committee?"

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TABLE 2 (Continued)

Information gathered in the interview	Prompts
Circumstances that led to the decision not to create a committee	- Similar to the questions above.
Level of knowledge regarding audit committees	- No specific prompts.
General observations about audit committees	- "Is there any additional information you can provide that may help me better understand the use of audit committees in local government?"

reasons why local government officials choose to not create audit committees, and (5) each respondent's level of knowledge regarding audit committees.

To answer the second research question, the researchers identified interviewee statements that provided information on (1) benefits and weaknesses of audit committees that are specific to the respondent's jurisdiction, (2) benefits and weaknesses of audit committees that the respondent has observed in other jurisdictions, and (3) general statements on the efficacy of audit committees in local government.

To answer the third research question, interview responses were analyzed for common observations regarding the rationale for creating audit committees and the benefits of and problems with audit committees. These observations were then assessed for their compatibility with the principal-agent logic that underlies the popular promotion of audit committees. It is expected that the principal-agent logic will be supported if local governments create audit committees in order to mitigate principal-agent problems. That logic will also be supported if public officials view the benefits of audit committees in terms of improved oversight and better financial reporting and audit committee problems in terms of their inability to improve oversight or the quality of financial reporting. The findings are presented in the next section.

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FINDINGS

The Creation of Local Government Audit Committees

Sixty-one of the local government respondents surveyed currently have an audit committee or recently had an audit committee. The reason for the committee's creation was unknown in 21 of those governments (See Table 3). Most of those 21 governments created their audit committees over ten-years ago and the reason for their creation was no longer commonly known—though respondents in five of those governments knew that their committee was not created in response to a financial scandal.

Of the 40 governments where the reason for the adoption of the audit committee is known, the most common reason (18 of 40) for implementing an audit committee is to improve financial oversight. Only five of those were created in response to a financial scandal, such as embezzlement or gross mismanagement of financial resources.

TABLE 3
Reason for Creating an Audit Committee

	Currently have an audit committee		Previously had an audit committee		Total	
Reason	Count	%	Count	%	Count	%
Respondent did not know	12	24.0	4	36.4	16	26.2
Respondent did not know, but knew it wasn't a scandal	5	10.0			5	8.2
Desire to improve oversight	12	24.0	1	9.1	13	21.3
State mandate	3	6.0	4	36.4	7	11.5
Other	5	10.0	2	18.2	7	11.5
In response to a financial scandal	5	10.0			5	8.2
In order to stay current with national trends in the private sector	5	10.0			5	8.2
To make better informed financial decisions	3	6.0			3	4.9

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Seven of respondents indicated that they adopted their committee in order to satisfy regulatory requirements—primarily state mandates that require local governments to use an audit committee when they select an external auditor. Most of the mandated committees are used only as needed—they are convened when the local government selects a new auditor and dissolved immediately after they have performed their mandated functions.

Five of the respondents indicated that national "best practices" are an important influence in the decision to create an audit committee. Also, 25 percent of the respondents from governments that are actively considering creating an audit committee indicated that national "best practices" are an important influence. GFOA recommended practices and administrative communities were identified as an influential source but respondents also indicated that elected officials are exposed to audit committees in their private employment or through business media and, as a result, are often champions of audit committees in order to stay current with the "state-of-the-art" in corporate governance.

Four of the respondents indicated that they created an audit committee in order to improve their government's financial decisions. In these situations, the audit committee performs finance committee tasks such as evaluating tax instruments and reviewing capital expenditure proposals. None of the governments identified the need to improve the quality of their financial reporting as a reason for creating their audit committees.

Principal-Agent Rationale and the Creation of Audit Committees

We have information on 40 governments as to why they implemented an audit committee; nearly half were adopted to improve financial oversight or in response to financial scandal. Of the jurisdictions that have never considered creating an audit committee, nearly 50 percent indicated that the primary reason they have not created a committee is because their existing internal controls are sufficient and they have not had a significant financial scandal. These findings provide evidence that audit committees are often created to mitigate principal-agent problems and are not created when government officials do not perceive their government to be at risk of financial misconduct—supporting the logic behind the popular promotion of audit committees.

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Other findings, however, suggest that concerns about the risk of principal-agent problems are insufficient antecedents to the creation of audit committees. Eleven of the 60 respondents whose governments have never considered creating an audit committee indicated that they have ongoing internal control problems or have recently experienced a large financial scandal, yet they have never considered creating an audit committee.

In addition, none of the governments identified the need to improve the quality of their financial reports as a rationale for creating an audit committee. This finding is especially interesting because a key reason for the Sarbanes-Oxley Act of 2002 was to improve investor confidence in financial reporting. These findings may suggest that government officials do not consider audit committees as a tool for improving their financial reporting. They may also indicate that improving the quality of their financial reporting is a low priority for most local government officials. Either way, government officials do not seem likely to create an audit committee to improve their financial reporting.

Perceptions of Benefits and Problems

Perhaps not surprisingly, most of the respondents from governments that recently dissolved their audit committees did not identify a benefit of audit committees (9 of 10). That view is not shared, however, by respondents in governments that currently have an audit committee where only 8 of 58 did not state a benefit of audit committees.

Of those respondents that stated a benefit, the most frequently cited benefits are that audit committees improve the communication of financial information between financial administrations and elected officials (32.8 percent) and, as the organization's financial practices are better understood, audit committees improve the credibility of financial managers and the quality of their practices (13.8 percent). Improved communication is also associated with the perceived benefit that audit committees can expedite financial decisions (6.9 percent).

Five of the respondents indicated that audit committees improve auditing and accounting practices. Only one of those five respondents

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stated that the audit committee was an effective tool in improving the quality of financial reports.

Three of the respondents (5.2 percent) indicated that audit committees benefit their government by reducing the amount of media oversight. Audit committee meetings are public meetings but receive significantly less media and public attention than meetings of the entire governing body. As such, some respondents explained that they are better able to discuss complex and controversial financial issues in audit committee meetings than is advisable in a city council or county commission meeting.

TABLE 4
Reported Benefits of Audit Committees

	Currently have an audit committee		Previously had an audit committee		Total	
Reported Benefits	Count	%	Count	%	Count	%
Improved communication of financial information between elected and administrative officials	19	32.8	00	0.0	19	27.9
None stated	8	13.8	9	90.0	17	25.0
Improved financial management practices	8	13.8	1	10.0	9	13.2
Improved credibility of financial management practices among elected officials	8	13.8	0	0.0	8	11.8
Improved auditing and oversight processes	5	8.6	0	0.0	5	7.4
Expedited financial decision processes	4	6.9	0	0.0	4	5.9
Financial deliberations less scrutinized by the media	3	5.2	0	0.0	3	4.4
More financial resources	3	5.2	0	0.0	3	4.4

The respondents also identified a variety of problems with audit committees (see Table 5). Those respondents who identified problems with their audit committees saw two broad categories of

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problems. One category of perceived problems included a variety of logistical challenges to effectively operate an audit committee. For example, respondents indicated that it is difficult (a) to engage their

TABLE 5
Reported Problems of Audit Committees

	Currently have an audit committee		Previously had an audit committee		Total	
Reported Problems	Count	%	Count	%	Count	%
None stated	21	36.2	6	60.0	27	39.7
Difficult to obtain participation of members	6	10.3	1	10.0	7	10.3
Members often lack sufficient financial knowledge	5	8.6	0	0.0	5	7.4
Committee has a difficult time making decisions	5	8.6	0	0.0	5	7.4
Hard to arrange meeting times	4	6.9	0	0.0	4	5.9
Government lacks sufficient resources for audit committee	4	6.9	1	10.0	5	7.4
Political pressures influence audit committee decisions	3	5.2	1	10.0	4	5.9
There is more work to do than audit committee can perform	2	3.4	0	0.0	2	2.9
Not enough work to do	2	3.4	0	0.0	2	2.9
Tensions arise when some council members have more financial information than others	1	1.7	0	0.0	1	1.5
Hard to know when to bring items to the committee	1	1.7	0	0.0	1	1.5
Audit committee doesn't communicate well with city council	1	1.7	0	0.0	1	1.5
Creates another boss for the finance director	1	1.7	0	0.0	1	1.5
The government already has too many committees	1	1.7	0	0.0	1	1.5
City council limits the committee's authority to keep power away from non-elected committee members	1	1.7	0	0.0	1	1.5
Not right for small towns	0	0	1	10.0	1	1.5

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members (10.3 percent), (b) to recruit members with sufficient financial expertise (8.6 percent), (c) to schedule committee meetings (6.9 percent), and (d) to manage the committee's workload (3.4 percent stated that there was too much work to perform and 3.4 percent stated that there is not enough work to keep the committee busy).

Respondents from governments that have not considered creating an audit committee frequently stated that audit committees are especially difficult to implement in small jurisdictions because those governments have less access to individuals who have sufficient financial expertise to add value as a member of their audit committee. The recruiting challenge of small jurisdictions is especially problematic because small jurisdictions are often more likely to have internal control weaknesses due to fewer resources.

The other category of problems with audit committees included a variety of political and organizational challenges to their use. For example, political pressures are likely to occasionally influence committee members (5.2 percent); audit committees can create tension because they provide some elected officials and citizens with more financial information than others (1.7 percent); and, audit committees can create another boss for the finance department (1.7 percent).

Principal-Agent Rationale and the Perceived Benefits and Problems of Audit Committees

These findings indicate that government officials rarely judge the success of their audit committees in terms of their ability to improve the monitoring of financial practices or the quality of financial reporting. More often, financial officers perceive the benefits of audit committees in terms of their ability to improve the communication of financial information and the problems with audit committees in terms of their logistical, political, and organizational challenges.

CONCLUSION

Drawing on a national sample of U.S. local government officials, this paper provides preliminary evidence on the reasons why local governments create audit committees and the perceptions of local government officials on the benefits and problems of those

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committees. The findings indicate that there are several factors that influence the creation of audit committees in local governments. The most common reasons are to improve financial oversight, to comply with state mandates, and to follow trends in corporate and governmental "best practices."

Interestingly, the findings also demonstrate that the reasons why audit committees are created have little to do with the perceived benefits and problems of these committees. The most commonly cited benefit of audit committees is their ability to improve the communication of financial information between public administrators and elected officials. The most commonly cited problems with audit committees are associated with logistical difficulties in recruiting qualified committee members and ensuring that they meet regularly. Other problems include difficulties associated with the political value of financial information and how audit committees increase the access to that information for some individuals.

Another important finding of this paper is that the logic behind the popular promotion of audit committees by the GFOA and in the private sector is poorly reflected in the use of audit committees in local governments. That is, efforts to improve financial oversight and the quality of financial reporting are only a part of the story behind the adoption and perceived efficacy of audit committees. Does this mean that the GFOA's recommended practices are misguided? No. Cross-sectional quantitative research on the effects of audit committees at improving financial oversight and report quality is needed to address the value of the GFOA's recommendations. This study clearly does not provide such an analysis.

The disparity between recommended and actual practices may actually provide a justification for the GFOA's leadership on this issue. This study identifies similar problems in the use of local government audit committees as those found within the corporate sector audit committees in the 1980s and 90s. Local government audit committees often meet infrequently, have insufficient resources, and their members commonly lack sufficient financial expertise. These are similar problems that corporate sector observers claimed would lead to financial oversight debacles in the private sector. This study, therefore, should be viewed as encouraging national trends with the

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recognition of practical and political barriers that must be considered if these trends are to diffuse without regulatory assistance.

It should be noted that these findings may be highly influenced by the common institutional role of the respondents. Elected officials may provide a different list of perceived benefits and problems. Further research should seek to include measures of benefits and problems that are less reliant on perceptions of a single type of official. Further research should also use a larger sample of governments to improve the external validity of the findings. As is, the findings should be considered preliminary.

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NOTES

1. The 195 local governments were selected because the researcher had self-reported data on whether they had an audit committee from a previous study conducted by one of the authors. That study was a mail survey completed by finance directors from 1,000 general-purpose local governments—randomly selected from a GFOA membership list that included over three-thousand members. The mail survey also collected data on the membership characteristics of the government's audit committee and the functions the audit committee performs. The response rate for the mail-survey was 19.7 percent (197/1000), of which 195 were usable.

   This sampling frame may lead to a few problems. First, a sampling frame of GFOA members may limit the external validity of the findings. Responses did demonstrate variability in geographic local, jurisdictional size, and form of government (i.e. city, town, and county forms). Responses were received from local governments in 42 different states—the median number of responses from any one state is three. Second, the low response

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rate could indicate bias in the respondents. The respondents appear to be comparable with the sampling frame in their regional location, population size and form of government. Third, there could be a concern that the responses would over-represent individuals that had more knowledge about audit committees. This concern is mitigated because the mail survey collected data on a variety of financial management practices; the audit committee questions were asked at the end of the survey and comprised less than twenty-five percent of the survey content.

The benefit of using these respondents is the availability of detailed information on the membership and functions of their audit committees. And, since the mail-survey had identified jurisdictions with audit committees, and those without, the researcher knew from the outset that there was a mix of both types of jurisdictions in the sampling frame—a national random sample of local governments, in contrast, could have produced a sampling frame with too few governments with audit committees, or too few without.

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