AUDIT ADVISORY BOARD MINUTES
MONDAY, MAY 18, 2009 AT 5:00 P.M.
CITY HALL, 1ST FLOOR, COMMISSION CHAMBERS
100 NORTH ANDREWS AVENUE
FORT LAUDERDALE, FLORIDA

	Cumulative January – December 2009	
Board Members	**Present**	**Absent**
Delores McKinley	1	0
Joseph Welsch, Chair	1	0
John J. Zullo	1	0

Staff
John Herbst, City Auditor
Renee Foley, Assistant Internal Audit Director
Michael Kinneer, Finance Director and Board Liaison
Marguerite Rosenberg, Controller
Lynda Flynn, Treasurer
Joanne Rizi, Finance Department
Shonda Singleton-Taylor, Acting Director, Office of Management & Budget
Charlotte Rodstrom, City Commissioner
Jamie Opperlee, Recording Secretary, Prototype, Inc.

External Auditors
Alyson Silva, Ernst & Young, LLP
Patrice Jones, Ernst & Young, LLP
Cynthia Borders-Byrd, C. Borders-Byrd, C.P.A., LLC

Communications to City Commission

None at this time.

- **Roll Call**

The meeting came to order at 5:03 p.m. Roll was called and all members were present. It was noted that the Board did not presently have a Chairman.

Motion made by Mr. Zullo, seconded by Ms. McKinley, to elect Mr. Welsch as Chair. In a voice vote, the **motion** carried unanimously.

- **Ernst & Young, LLP Financial Statements – FYE September 30, 2008 Audit Results, Communications, and Report to Management**

Alyson Silva, representing Ernst & Young, LLP, introduced the members of her team and stated she would go over the audit results, beginning on p. 4, with a summary of deliverables.

Ms. Silva explained that the “opinions” section refers to the opinion the auditors will issue on the City’s basic financial statements; they also included a special report on the City’s waste water treatment rate and computation. Regarding the status of the report, the Large User Report is complete and in the review process; the opinion will be issued once the audit’s wrap-up procedures are complete, which is expected to be later this week.

The external auditors will also need a Letter of Representation from Management, which allows them access to bank accounts. This is one of the last details once other procedures are complete, she advised. The firm’s quality review procedures are nearly finished, and their independent partner has reviewed their findings as well. They also require legal letter updates, of which roughly seven are being updated this week.

Regarding internal control communications, Ernst & Young issues a report in accordance with government auditing standards on internal control over financial reporting. In that, they will discuss the significant deficiencies and weakness that have been identified. This report will be reviewed at the end of this presentation, Ms. Silva stated.

Among other services, they also issue a single audit report and a Management letter. A draft copy of the Management letter has been provided, and will also be reviewed near the end of the presentation. The single audit is close to completion, and Ms. Borders-Byrd will give a brief update on its status.

Ms. Borders-Byrd announced that the single audit by C. Borders-Byrd, C.P.A., has been “substantially completed.” There were originally 10 grants that required auditing, although it was learned that the FEMA grant should be eliminated from this list, leaving nine grants in need of auditing. Four are related to housing, and five are from various other Departments in the City.

The field work is being concluded with respect to the housing grants, and “a number of findings” to report. They expect to present the City with a draft of their findings by next week so written responses may be prepared. Once this process is complete, it will be approximately 7-10 days before the single audit report can be issued.

Ms. Borders-Byrd clarified that her firm had reviewed the FEMA grant and tested controls for compliance; the result was identification of a number of transactions that were disallowed. Upon further investigation, they learned that these costs should not have been included in the material the City gave the firm for testing;

once these were eliminated, the FEMA grant fell beneath the threshold for testing.

Ms. Silva was not aware if FEMA had been previously billed for these costs, as this was a financial audit; nor did Ms. Borders-Byrd, who pointed out that she is testing for expenditures only. Ms. Rizi did not believe a reimbursement request had been submitted for this grant, as it was related to permanent repairs, and the disallowed transactions could be adjusted out before any such request was submitted.

Mr. Zullo inquired if any of the federal granting agencies (federal auditors) audited the city's programs and if so did they have any audit comments or findings? Ms. Borders-Byrd confirmed this, explaining that monitoring occurred and written reports were issued for "almost all" the housing grants. Her firm has requested updated versions of these housing grants at this time, but has not yet received them.

Chair Welsch asked if deficiencies were reported for any of the grants. Ms. Borders-Byrd advised that "significant deficiencies" were reported that related to compliance, eligibility requirements, and proper documentation to support qualifications. When asked if misuse of funds was one such deficiency, she pointed out that it could be argued that deficiencies in eligibility requirements could be considered a misuse of funds; however, there had been no evidence of fraud.

Mr. Herbst asked if Ms. Borders-Byrd had seen the final letter that is scheduled to appear on the City Commission agenda at the May 19, 2009 meeting, which requests that $2.5 million in ineligible costs related to HUD grants be returned to that entity by the City. Ms. Borders-Byrd responded that she had not been aware of this specific letter. Mr. Herbst noted that the letter is a matter of public record.

Mr. Herbst continued that the City Commission's final determination was that $2.5 million from the original amount of the grants was deemed to be ineligible, as it is not "in pursuit of a national objective." The City must either pay these funds back or attempt to come up with a settlement agreement that applied future expenditures to the national objectives. He added that Staff should be able to provide Ms. Borders-Byrd with a copy of the letter.

At this time, Ms. Silva directed the Board to p. 5 of Ernst & Young's report, which contains a summary of the report's categories, including required communications, auditors' findings and observations, critical policy adjustments, and a summary of audit differences.

P. 6 addresses required communications, which lists auditors' responsibilities under generally accepted auditing standards. Additional government auditing standards report communications include a schedule that compares and contrasts different types of services that can be provided under auditing standards. Ernst & Young also provides a peer review report to the City.

The auditors' judgment regarding the quality of the City's accounting principles found them to be consistent with industry standards and have been applied appropriately, and that financial statements and disclosures have been provided in a clear manner. They did note, as in 2008, that the capital projects fund had internal loan transactions, which will decrease with every year until they disappear entirely. Ms. Silva advised that these are not material to the financial statements. She added that these will be listed in the audit differences as well.

P. 7 lists significant audit adjustments and unrecorded audit adjustments that are considered to be immaterial, she continued, and will be discussed farther along in the presentation. There were no disagreements between auditors and Management, and the team was not aware of any consultations that Management may have had with other accountants.

P. 8 confirms that Ernst & Young are independent and have not performed any non-audit services for the City during FY 2008. Regarding the adoption of the change in accounting principles, there were none, save that the City did adopt GASB statement 45, which is on accounting and financial reporting for employers of post-employment benefits other than pensions. This resulted in the City recording a liability of $5 million in financial statements; while the total actuary-approved liability is upward of $40 million, the amount that was actually booked on their financial statements in FY 2008 was approximately $1 million.

Mr. Herbst referred to p. 7, noting that the City had retained two other auditing firms to perform program-specific audits for the Waterworks and the Fire Station Bond Program, and asked if the reports prepared by these firms were used by Ernst & Young in preparing their own. Ms. Silva replied that they had not, and added that the consulting statement referred to the possibility that, should there be an accounting transaction that Ernst & Young felt should be accounted for in a particular way and the City disagreed, the City might have contacted a second firm for an additional opinion.

Moving on to p. 9, methods of accounting for significant unusual transaction or controversial or emerging areas, she reported that they were aware of no such activities. There were no major issues to discuss with Management with regard to their retention as auditors, and no serious difficulties were encountered in dealing with Management with regard to the audit.

Chair Welsch asked how Ernst & Young bid on the audit contract, and who was present during contract negotiations. Ms. Silva replied that the five-year agreement dates back to 2006 and will be up for renewal in 2010. They had discussed the fee with the City's Finance Director. Ms. Rizi affirmed that Ernst & Young negotiates the fee annually, but there is a maximum.

Ms. Silva continued that significant deficiencies and material weaknesses would be covered as part of the internal control report. The third party service provider was Ms. Borders-Byrd, who assisted with the single audit.

Pp. 11-13 summarize the auditors' key findings and observations, she stated, and referred the Board to Patrice Jones, also of Ernst & Young, who would go over these results.

Ms. Jones advised that these pages included results from procedures performed. With regard to revenue recognition, unearned revenue, and modified accrual, the auditors have updated their understanding of the processes performed, types of control over these processes, and performed analytical procedures over the revenue. In some cases, if the revenue is significant with regard to the General Fund, the auditors confirmed the revenue. There were no significant differences observed in this area.

With regard to investments, major procedures involved direct confirmation of investments and testing of these evaluations through tests of specific securities. They also looked at alternative investments where readily available fair value does not exist, and assessed the City's policies in looking at the assumptions and value of these investments. They have identified $1.3 million in declining fair value in real estate investments held by pension funds. There was an appraisal of this decline that was obtained by the City; however, the appraisal was not forwarded to the Finance Department in a timely manner, nor was the accrual. This was noted in the audit of the fair value of the investment, which was identified as the General Employees' Retirement Fund.

The auditors also identified two additional errors as a result of their confirmation procedures: interest receivable was understated by $400,000, and investments were overstated by $279,000. These were discovered while preparing the confirmations to what is recorded on the City's books. Due to the immateriality of the adjustments, they were not recorded by the City.

Chair Welsch noted that the interest from monthly statements is recorded by the City, and asked how these might have been missed. Ms. Silva felt the issue was one of oversight.

Ms. Jones continued that with regard to accounts receivable, a sample of the outstanding accounts receivable were tested, mainly through subsequent cash receipt procedures. As a result, the auditors identified an error in the expenditures recorded under FEMA. $426,000 was ineligible for reimbursement under FEMA; the auditors propose to reduce the receivables and the related revenue. The adjustment was not recorded by the City and was included in the list of differences due to the immateriality of the amount.

She continued that this was part of the Intergovernmental Revenue Fund, which is one of Ernst & Young's "non-major" funds. It was not considered to be material to the financial state of the City.

They also identified $21 million in FEMA receivables that remain outstanding as of the end of FY 2008 (September 30, 2008). The City expects to collect this balance in full; however, there has been limited activity during the year on this item through the year, and the auditors are assessing what the impact on the availability criteria will be.

Ms. Jones continued that the auditors understand the City has "run into some issues" with FEMA, with regard to someone coming to perform the audit; that individual has since left FEMA, and there is no "trail of results" that the individual had identified through their audit. The FEMA difficulty in question dates primarily to Hurricane Wilma, Ms. Silva added.

Ms. Jones moved on to discuss capital losses and depreciation. Ernst & Young have tested a sample of acquisitions and dispositions, calculated reasonable depreciation, and calculated the reasonableness of interest capitalized during the period in question. With regard to interest capitalization, they have noticed that one loan is excluded from the calculation, a State Revolving Fund Loan, in the amount of $250,000; this loan was not properly capitalized since it closed. The adjustment was found to be immaterial and was not recorded by the City.

For self-insurance and liabilities, the auditors have obtained the respective actuary reports and reviewed it for feasibility and competency of the actuary. Their internal actuary firm has also examined the liability and tested the data submitted to the actuary for reasonableness. No difficulties were identified in this area.

For long-term debt, Ernst & Young confirmed all outstanding balances as of year-end, and tested interest expenses. No differences were identified. For accounts payable and accrued liabilities, the significant balances have been tested and details reviewed on unusual balances; they have also performed a search for unrecorded liabilities, which identified approximately $3 million of these that were not recorded in the correct period. Ernst & Young proposes an adjustment for this amount recorded by the City.

Commitment to contingencies, City Commission minutes, and circulated legal letters and responses have also been reviewed. No significant matters were identified with these items. Federal and State grant compliance have been discussed previously.

Ms. Jones returned the report to Ms. Silva to discuss critical policies, estimates, and areas of emphasis.

Ms. Silva explained that this area summarizes critical policies and estimates, which are disclosed in the notes of the financial statements. The auditors found that the policies appear reasonable, as do estimates when they are involved.

She referred to p. 16, which includes the procedures Ernst & Young follows with respect to fraud. They gathered information to identify what they felt are the fraud risks, and listed procedures that would address these risks, including examination of journal entries, accounting estimates, and examining unusual transactions. They did not discover any matters involving fraud.

She asked the Board members at this time if they were aware of any allegations of fraudulent behavior, of which the auditors should also be aware. No such allegations were cited.

The summary of audit differences, Ms. Silva continued, includes the items already discussed as being reported or not reported. The schedules, beginning on p. 18, take each unit upon which the auditors have stated an opinion, such as major findings in governmental or business activities and other categories.

Mr. Herbst asked why Staff had opted not to restate the FEMA monies. Ms. Rosenberg stated that it "wasn't significant," and the City did not choose to open the books at the time. She added that FEMA is now being looked into regarding another issue; however, the amounts were considered insignificant and the City now needs to close those books. The amounts will "net out" by the end of fiscal 2009.

Ms. Silva moved on to p. 26, a section on accounting and auditing development. She identified this as a "look ahead," including a statement of standards that conforms to new definitions used by public companies, which would make small changes to the material Ernst & Young had just covered. For example, "significant deficiencies" will now be described as "a deficiency or combination of deficiencies that an auditor judges as less severe than material weakness but important enough to merit attention by those charged with governance." These new definitions will go into effect on or after December 15, 2009.

Following statements addressed pollution remediation obligations, accounting and financial reporting for intangible assets, consistency of reporting land and other real estate reported at market value, accounting and future reporting for derivative instruments, clarification of plan balance classifications, incorporation of standards into the GASB's formal literature, new bond disclosure regarding IRS policy to monitor issuance and record retention policies of government issuers, and timetable for required communications. These GASB statements are included in pp.27-32 of the auditors' report, she pointed out. They are scheduled to take effect between FY 2009 and FY 2011.

Chair Welsch asked if Staff is up to date on the earliest of the changes that Ms. Silva had described. Ms. Rosenberg affirmed that this information is communicated appropriately to Staff.

Ms. Silva next addressed the internal control report, which auditors are required to provide. She pointed out that the internal control for financial reporting identifies what would be significant deficiencies or material weaknesses. She referred the Board to p. 2, which lists items 2008-1 and 2008-2 as the significant deficiencies observed by the auditors. They also noted recurring issues that have not yet been addressed, which remain material weaknesses.

Ms. Jones called the Board's attention to 2008-1, which notes that the City's pension trust's real estate holdings total approximately $43 million; there are "other alternative investments" totaling $19 million, consisting of venture capital and partnerships of $8 million in the Police and Fire Fund and a guaranteed investment trust in the General Employees Retirement Fund for approximately $11 million.

What Ernst & Young noted here, she explained, is that with regard to the valuation of the investments, there is no readily available fair value for them. Therefore, the City should perform certain procedures to challenge the accuracy of the fair value. The auditors did not know when these procedures were last performed; therefore, their recommendation is for the City to establish such procedures.

Item 2008-2 is in regard to accruals and accounts payable. It is a direct effect of the adjustment of approximately $3 million in the Water and Sewer Fund in the current year. Ernst & Young noted that there were invoices received subsequent to the year's end for services rendered during the prior fiscal year, which should be recorded in the proper period. Their recommendation is that the City should strengthen its control and review process to ensure that these items are recorded in the correct period.

Ms. McKinley asked when the Management response to the report would be available. Ms. Rosenberg estimated this would be within the "next several days" and added that it will be made available to the Board.

Ms. Jones moved on to the prior year's findings, pointing out that Accounts Receivable for utilities is the result of that entity's "antiquated" billing system, which allowed the auditors to identify issues such as the aging of past due accounts and certain credit balance detail unavailability. The City has approved the purchase of a new system, which is expected to be implemented in April 2010, she noted.

Mr. Kinneer confirmed that this conversion is underway. The original timetable for implementation is 19 months, and he pointed out that the City is four months into the process.

Chair Welsch noted that many payments to the utility system are now done online or via automatic draft, but these customers still receive envelopes with their statements. Ms. Rizi stated that the current system is still supported by its vendor, but due to its scheduled replacement they are no longer making improvements to it.

Ms. Jones continued that in prior years two and three, the large amount of capital assets made recordkeeping via Excel spreadsheet “prone to error.” The recommendation is for an automated process, which is also expected to be implemented in 2010. They also recommend that the physical inventory of capital assets be performed in conjunction with the installation of the new capital asset system.

Ms. McKinley asked if it would not be better to take a physical inventory at this time, before the implementation of the new system. Ms. Rosenberg pointed out, however, that it would be “laborious” to go through a physical inventory without an automated system.

Ms. Jones went on to point out that her third item would be part of the single audit report that will be provided. She referred to p. 10, findings from the prior year including the current year’s status. Management responses have been reviewed and are acceptable to the auditors, she stated.

Moving on to the Management letter, Ms. Jones reiterated that the items listed do not attain the level of significant deficiency or material weakness, although they are included in the letter. The first item is the FEMA accrual, as Ernst & Young identified the limited activity of the current year, resulting in a $22 million balance as of year-end. They have identified approximately $426,000 in expenditures that were not considered reimbursable under FEMA. As a result of this error, the auditors have determined that Management should continue to monitor the likelihood of the collection of receivable very closely.

She continued to debt covenants, noting that the City was in compliance throughout the year but could not provide year-end debt covenants on a timely basis. Their recommendation is that the City routinely monitor these debt covenants on a semi-annual basis.

Regarding interest receivable, Ms. Jones clarified that this refers to the errors identified when the balance as recorded was compared to the balance included in the investment statement. The recommendation is that the City undertake a more detailed review of the investment statement in conjunction with their investment reconciliation procedures.

The next item, capitalized interest, is the result of adjusting entries, as the auditors noticed that one loan was excluded from the calculation. They recommend that the City ensure that all loans applicable under guidance in the calculation of capitalization are included.

The final item is with regard to other benefits contribution, in which a third party administrator was not reporting retiree claim data separately from active employee claims. The recommendation is that these be separated going forward.

Ms. Jones advised that the section on “Prior Year Recommendations” contains duplicates from prior years. They have reviewed Management’s current status responses and found them to be reasonable.

Mr. Zullo asked if any of the current audit findings were items that were also reported in the previous year’s audit. Ms. Silva noted that these are “new or different” issues; others, such as capitalized interest, were corrected after they were noted the previous year. She noted that some items might conceivably have been “at a different level” before being cited this year.

Chair Welsch asked if Ernst & Young had any comments on the City’s growing reserves, regarding, for instance, the percentage normally kept by a City. Ms. Silva replied that there were no comments on this issue.

She stated that this concludes Ernst & Young’s presentation.

Mr. Zullo commented that he had not seen the previous meeting’s minutes for approval. Chair Welsch stated that the Board had not received a copy of these minutes “over a year ago,” and continued that if there is a set of minutes in need of approval, this can be done at the next meeting if copies are provided.

Mr. Zullo asked if it is a reasonable objective for the City to strive for zero deficiencies. Mr. Kinneer felt this would be “an admirable goal,” but did not know when this might happen.

Mr. Zullo stated that his last issue is with regard to the timing of the report, and asked how this audit compares to previous audits in the timeliness of its completion. Ms. Silva replied that in the past, the audit has been completed more quickly in previous years; this year’s audit received an extension.

Mr. Herbst agreed that it is the City's goal to have the audit completed in a more timely fashion.

Chair Welsch asked if the timing of the audit impacts any recording requirements for Federal, State, or other agencies. Ms. Silva reiterated that while the GFOA deadline has passed, an extension was received for this audit. She added that the single audit is not due until June 2009.

Mr. Herbst pointed out that the State deadline for an audit is 12 months after the fiscal year.

Ms. Rosenberg stated that she and Mr. Kinneer had "initiated some changes" for timelines and processes within City Departments, which would affect recording, invoicing, and other considerations. This was received with "huge support" from the Assistant City Manager, she noted.

- **Other Business**

Chair Welsch asked what might be an appropriate date for the next meeting, specifically asking Staff and Commissioner Rodstrom what benefits the Board provides them and how to make an even better contribution in the future.

Commissioner Rodstrom stated that this had been a very informative meeting, and agreed that the new Staff has a good deal on which they must catch up. She hoped next year's audit will be received in a more timely fashion to prevent this from recurring.

Chair Welsch noted that the rules of the Audit Advisory Board state that the Board participates in the negotiation of the contract; however, he did not know if the Staff wanted this to continue or to change this particular rule.

Mr. Herbst stated that in the past, there was an Audit Advisory Board and an "Audit Selection Committee," which approved the engagement of the auditors. The latter body is required by State law. While it was originally made up of Staff members, Mr. Herbst emphasized that he believes the Audit Advisory Board should select the auditors; he is opposed to this being done by an Audit Selection Committee, which he feels is a conflict. He stressed that part of the Board's charge should be the engagement of the auditors, which is the way this is usually done in the private sector.

Chair Welsch pointed out that in the private sector, any such selection committee consists of paid employees, while a citizens' advisory body "takes on a different perspective." He noted that a procurement service usually takes on this responsibility rather than the Accounting and Finance Department in any case.

Mr. Herbst felt that the responsibility ultimately falls to the City Manager, and in the private sector any such audit committee is in reality the board of directors of a private entity. If the City Commission is considered equal to a board of directors, he continued, the Audit Advisory Board is their representative.

He pointed out that Sarbanes-Oxley specifically prohibits members of any staff from assuming this responsibility in the private sector. Commissioner Rodstrom added that the Board's expertise is needed, as it is different from "what Staff would bring to the table."

Ms. Silva clarified that both Chair Welsch and a member of the Budget Advisory Board had been on the Audit Selection Committee.

Ms. Rosenberg pointed out that she had requested Ernst & Young to provide the City with their engagement letter and audit plan for FY 2009 in July 2008, and that this request was not met. She hoped to improve processes during this year, and asked that Ernst & Young plan to provide these materials in July 2009.

Mr. Herbst felt if the Board disagreed with any of Management's responses as presented by the auditors, they were obligated to bring this to the City Commission's attention. It was noted that the Management response should be ready by the following Wednesday night (May 20, 2009) and can be emailed to the Board members. Mr. Kinneer clarified that Staff plans to bring the report before the City Commission in June.

Mr. Herbst emphasized that once the requested material is available to the Board, there can be no discussion of it between Board members outside of a scheduled meeting due to the Sunshine Law.

Ms. Rizi commented that Staff does not dispute any comments made on the audit, and have not suggested they would not implement the recommendations made.

Ms. McKinley pointed out that the Board met last year, but then did not meet for several months. She hoped that they can meet more regularly in the future, and urged Staff to "get [the Board] more involved." Chair Welsch noted that they might also consider asking the City Commission to appoint more members to the Board as well.

Ms. McKinley continued that most Audit Advisory Boards have input on audits before they are presented to the City Commission.

Ms. Foley stated that older audits are available on the City's website for Board members who would like to review them. Mr. Herbst added that his audits are available on the website as well, but are on the City Auditor's page. His audits are also confidential until they are presented to and approved by the City Commission, he noted.

There being no further business to come before the Board at this time, the meeting was adjourned at 6:10 p.m.

[Minutes prepared by K. McGuire, Prototype, Inc.]