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December 9, 2009

FINAL REPORT TRANSMITTAL LETTER

Honorable Wayne County Commissioners:

Enclosed is our final copy of the Office of Legislative Auditor General's consulting report on our Review of the County's External Audit Costs, Fiscal Years 2003-2008, Wayne County Department of Management & Budget. Our report is dated November 2, 2009; DAP No. 2007-57-008. The contents of this final report did not change from the draft report previously issued. The report was accepted by the Audit Committee at its meeting held on November 10, 2009, and formally accepted by the Wayne County Commission on November 19, 2009.

We are pleased to inform you that officials and staff in the Department of Management & Budget particularly the Financial Reporting Division offered their full and complete cooperation during the review. If you have any questions, concerns, or desire to discuss the report in greater detail, we would be happy to do so at your convenience. This report is intended for your information and should not be used for any other purpose. Copies of all Office of Legislative Auditor General's final reports can be found on our website: http://www.waynecounty.com/mygovt/comm/AuditReport.aspx.

Willie Mayo, CPA, CIA, CICA
Auditor General

REPORT DISTRIBUTION

Department of Management & Budget
Carla E. Sledge, Chief Financial Officer
Christa J. McLellan, Director of Financial Reporting
Terry L. Hasse, Director, Grants and Contract Administration

Wayne County Executive

RESOLUTION

No. 2009-771

By Commissioner Woronchak and Co-sponsored by Commissioner Varga

WHEREAS, the county's external audit costs have certainly spiked from 2003's contract amount of $530,000 to $1.6 million paid for the 2008 audits; and

WHEREAS, though the county's external audit costs are higher than those surrounding counties, they are lower than those paid by the city of Detroit; and

WHEREAS, when compared to local units of government and nationally of similar population or budget, the county's per capita costs are higher; and

WHEREAS, comparisons of audit costs are extremely challenging and difficult and may not provide the most meaningful analysis since audit costs are based on so many different factors and are unique to each entity's risk factors; and

WHEREAS, to control and possibly reduce the county's and the component units/agencies; audit costs, the Department of Management and Budget, Financial Reporting Division along with the component units/agencies consider the feasibility of contracting with a single external audit firm to perform all required annual audits for Wayne County; and

WHEREAS, to control and possibly reduce the county's audit costs, the Wayne County Commission should consider amending the charter and/or ordinances to allow the external audit firm for the county to contract for a minimum of 5 years and remove or lengthen the period of time a single auditor can continually serve as independent auditor from 8 to 10 years; and

WHEREAS, to control and possibly reduce the county's and the component units/agencies' audit costs, the Wayne County Commission should require the DWCCMHA to provide a business and/or other acceptable justification and rationale why it requires a separate audit for its financial activity prior to approving any separate audit contracts;

Now therefore be it

RESOLVED, by the Wayne County Commission this 19th day of November, 2009 that approval be, and is hereby, granted approving the office of the Auditor General's final draft consulting report titled, Review of the County's External Audit Costs, Fiscal Years 2003-2008, Department of Management and Budget. The report is dated November 2, 2009.

(2007-57-008)

DAP No: 2007-57-008

County of Wayne

Department of Management and Budget

REVIEW OF THE COUNTY'S EXTERNAL AUDIT COSTS FISCAL YEARS 2003 - 2008

Consulting Report

November 2, 2009

EXECUTIVE SUMMARY

Why We Performed this Engagement

The county's external audit and related costs increased more than three times from the initial contract price in FYs 2003 to 2008. The costs went from $530 thousand to $1.6 million, respectively. The Wayne County Audit Committee requested the Office of Legislative Auditor General (OAG) to assess the external audit costs to the County of Wayne and the internal control environment that determine these costs and provide recommendations, if applicable, how management and internal controls over these costs could be strengthened.

The specific objectives for the engagement were:

1. Identify the risk associated with external audit costs and factors that determine the costs;
2. Determine and assess Wayne County's external audit costs, and perform comparative analysis; and,
3. Assess Wayne County's management and internal controls over external audit costs.

Background

Applicable State of Michigan and County of Wayne statutes, charter, or ordinance require the county to obtain an annual independent audit and the audit must be completed and filed by a date certain. The state deadline is March 31st after the fiscal year ends; the county requirement is January 31st, after the fiscal year ends.

The annual audit is an important document; it serves as a report on the condition of the county's financial health. It is the primary tool used by bond rating organizations to assess the credit

worthiness of the county, which determines whether the county can issue necessary bonds and at what interest rates. Preparation of the annual financial statements is the responsibility of the Chief Financial Officer of the county. Those duties are primarily delegated to the Financial Reporting Division of the Department of Management and Budget. The charter as amended designated the hiring of the external auditor to the county's Legislative Auditor General, with the approval of a majority of the County Commission.

The costs for the annual audit are recorded in the accounting records in the following fiscal year. For example, the costs recorded in FY 2007 accounting records for external audit costs are actually for the FY 2006 audit. This lag is consistent with the county's accounting treatment for external audit costs and is allowable in accordance with generally accepted accounting principles

What we did

Our review was generally limited to assessing information provided by Wayne County management officials, officials from Oakland, Macomb, and Washtenaw counties, the city of Detroit, and other governmental entities of similar population and budget. We also obtained and assessed external audit financial data recorded in the county's general ledger system for the fiscal years 2003-2008. We obtained other information and performed procedures considered necessary in order to address the engagement objectives.

To determine cost trends, we obtained information on external audit costs from both the private and public sectors including the Government Finance Officers Association and the American Institute of Certified Public Accountants. We made inquiries of management officials at Wayne County from various departments and agencies regarding specific contracts entered into for annual audit services. We discussed factors that may contribute to an increase in external audit costs with officials from the county's external auditors along with officials from the county's Financial Reporting Division. We also contacted other counties with similar population and budget aspects of Wayne County to determine their external audit costs. The fieldwork for the engagement was generally completed on November 2, 2009.

Objective (1)

Identify the risk associated with external audit costs and factors that determine the costs.

Risk in any area is dynamic and forever changing; this is certainly true for external audit costs. The risk associated with external audit costs are escalating and increasing costs beyond normal and acceptable inflationary increases. The factors that determine an entity's external audit costs are both external and internal. External factors are less controllable than internal factors. The external factors that affected external audit costs during the period of our review included:

1) increase in the number and complexity of audit standards in response to large corporate failures in 2002. During the review period 11 new significant audit standards came into effect;

2) reduction in the number of qualified auditors performing government audits in our market area; and,
3) risk due to litigious society.

The internal factors that affect the external audit costs include:

1) qualifications and competency of accounting staff and officials;
2) quality and timeliness of work schedules provided to the external auditor;
3) "tone at the top" of an organization (this refers to leadership and senior management's attitude and actions taken regarding fraud, waste and abuse); and
4) quantity of year end adjustments and efficiencies noted in the internal control environment.

Observation(s)

The primary risk to the county as it relates to external audit costs and fees is escalating and increasing cost beyond normal inflationary increases. Many external and internal factors affect an entity's external audit costs and fees. Though many external factors affect the costs of annual audits, those factors are primarily outside the control of an entity. However, the county can strengthen internal controls over perceived risk to positively impact external audit costs and fees.

Objective (2)

Determine and assess Wayne County's external audit costs, and perform comparative analysis

For the fiscal years 2003 through 2008 Wayne County and its component units/agencies have spent $10.3 million for its annual audits. Specifically, over this period the county alone has spent over $8.2 million for the county's Comprehensive Annual Financial Report (CAFR), and just over $1 million in additional costs for the FY 2003 forensic investigation. The county's component units/agencies spent $1.1 million for its audits over this period. A summary table of the costs is below and a detailed table is contained in the appendix.

External Audit Costs
Wayne County and Component Units/Agencies
FYs 2003 – 2008
($ millions)

Agency	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	Total
CAFR & Related	$1.2	$1.7	$1.2	$1.4	$1.3	$1.4	$8.2
Forensic Audit and Related Costs	$1	0	0	0	0	0	$1
Sub-Total	$2.2	$1.7	$1.2	$1.4	$1.3	$1.4	$9.2
Component Units/Agencies	.03	.2	.2	.2	.2	$.2	$1.1
Total	$2.3	$1.9	$1.4	$1.6	$1.5	$1.6	$10.3

During the period of our review, the county's component units and agencies audit costs also grew. They were $33,750 for 2003 and $239,939 for 2008; that represents a 610 percent increase. Most of the increase is attributable to the separate audit of the Detroit Wayne County Community Mental Health Agency (DWCCMHA). Prior to fiscal year 2004, the DWCCMHA audit was always included within the county's basic audit or Comprehensive Annual Financial Report. The justification and need for a separate audit may no longer be cost beneficial. We spoke to the county's current external auditors; they indicated the county could possibly save between $15,400 and $35,000 annually if the auditor of the CAFR also performed the audit of DWCCMHA. If the separate audit of DWCCMHA is eliminated, the cost savings could be even more than what is stated above.

In comparing the county's audit cost to surrounding counties, our cost was significantly higher, but lower than the amount paid for the city of Detroit's audit. When we compared the county's cost to other counties nationally, of similar population or annual budget, the county's cost was again measurably higher. When we compared the county's cost increases to the national trend for all entities, not just governments, the county's percentage increase from 2001 – 2006 was 296 percent compared to 350 percent for the same period. Here the county fared somewhat better.

It appears the county was caught in a perfect storm of circumstances that contributed to the increases in costs. The circumstances included, but were not limited to:

1) reduction in audit firms performing government audits in our market
2) increase in audit standards
3) need for and results of forensic audit
4) external auditors' perception of increased audit risk
5) lack of "county-wide" code of ethics and hotline

Observation(s)

The county's external audit costs have certainly spiked from 2003's contract amount of $530 thousand to $1.6 million paid for the 2008 audits. Though the county's external audit costs are higher than those of surrounding counties, they are lower than those paid by the city of Detroit. When compared to local units of government and nationally of similar population or budget, the county's per capita cost are again higher. Moreover, comparisons of audit costs are extremely challenging and difficult and may not provide the most meaningful analysis since audit costs are based on so many different factors and are unique to each entity's risk factors. Nevertheless, when the county's audit cost is compared to the national trends, the county's increase in cost is very comparable for the period of our review. Our analysis did determine that opportunities exist for the county to enhance or strengthen policies, procedures, and internal controls to control future external audit costs.

Recommendation 2009-01

To control and possibly reduce the county's and the component units/agencies' audit costs, we recommend the Department of Management & Budget, Financial Reporting Division along with the component units/agencies consider the feasibility of contracting with a single external audit firm to perform all required annual audits for Wayne County.

Recommendation 2009-02 (A) and (B)

To control and possibly reduce the county's audit costs, we recommend the Wayne County Commission consider amending the charter and/or ordinance to:

(A) allow the external audit firm for the county to contract for a minimum of 5 years and not 3 years as the current law requires.

(B) remove or lengthen the period of time a single auditor can continuously serve as independent auditor from 8 years to 10 years.

Recommendation 2009-03

To control and possibly reduce the county's and the component units/agencies' audit costs, we recommend the Wayne County Commission require the DWCCMHA to provide a business and/or other acceptable justification and rationale why it requires a separate audit for its financial activity prior to approving any separate audit contracts.

To reduce the county's perceived risk:

Recommendation 2009-04

We recommend the Wayne County Commission consider revising the procurement ordinance to establish stringent penalties and sanctions to management officials for the submission of retroactive contracts.

Recommendation 2009-05

We recommend the Wayne County Commission, Executive Branch, and all other County-Wide Elected Office Holders strongly consider the establishment of a county-wide Code of Ethics and Hotline.

Objective (3)

Assess Wayne County's management and internal controls over external audit costs

During the early years of our review period, the county had many challenges to preparing, completing, and filing its audited financial statements when required by the state and county deadlines. However, mid-point through the period the Chief Financial Officer (CFO) implemented a corrective action plan that included, but was not limited to: a department re-organization, staff enhancements, training, re-engineering of key processes, and monthly financial closings and reporting; those measures allowed the county to be compliant with the filing deadlines for the state since FY 2006's audited financial statements.

Observation(s)

Though the county had significant challenges in the early period of our review with preparing and filing its audited financial statements by the deadlines outlined in state statute and county charter and ordinances, they had generally eliminated or mitigated those challenges by the end of our review period. The measures taken by the CFO and her leadership team now appear sufficient to ensure the county's internal controls over external audit cost will result in the county's future cost in the area being stable and only subject to normal inflationary increases. Thus, the management and internal controls over external audit costs appear sufficient. To ensure the measures taken remain effective, the CFO and her leadership team must ensure the loss of key financial reporting personnel does not cause disruptions to the gains achieved in this area.

Noteworthy Accomplishments

The county and its financial reporting team should be commended for receiving the Government Finance Officer Association's Certificate of Achievement for Excellence in Financial Reporting three of the six years covered by our examination. Also, the Chief Financial Officer and her

team should be commended for taking appropriate actions after the forensic investigation to return the county to timely financial reporting and filing with the State of Michigan.

Views of Responsible Officials

The current audit fees are based on situations that existed in 2003. Since that time, as noted in the OAG's report, M&B has improved processes and procedures and now has an efficient financial reporting process which includes providing comprehensive audit support in a timely manner. These improvements alone warrant a decrease in audit costs. Given declining revenues throughout the state, it is reasonable that audit firms decrease fees to align with their client's ability to pay. Management and Budget encourages the OAG to approach the county's current external auditors in an attempt to realize cost savings.■

DETAILED REPORT

PURPOSE/OBJECTIVE

The Wayne County Audit Committee requested the Office of Legislative Auditor General (OAG) to assess the external audit costs to Wayne County and provide recommendations, if applicable, on how management and internal controls over these costs could be strengthened. This request was the result of external audit costs increasing more than three times in amount from the initial contract price of $530 thousand for fiscal year 2003 to $1.6 million for fiscal year 2008.

The objectives of our consulting engagement were to:

1. identify the risk associated with external audit costs and factors that determine the costs;
2. determine and assess Wayne County's external audit costs, and perform comparative analysis; and,
3. assess Wayne County's management and internal controls over external audit costs.

SCOPE

This engagement is not an audit in accordance with Generally Accepted Government Auditing Standards issued by the Comptroller General of the United States. We performed a consulting engagement in accordance with the International Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors (IIA). Those standards require us to plan and perform the engagement to obtain sufficient, appropriate evidence to provide a reasonable basis for our recommendations and conclusions based on the engagement objective(s). We believe that the evidence obtained provides a reasonable basis for our recommendations and conclusions based on the engagement objectives. A consulting engagement is limited in scope and does not require the performance of in-depth auditing procedures.

METHODOLOGY

Our review was generally limited to assessing information provided by Wayne County management officials, officials from Oakland, Macomb, and Washtenaw counties, the city of Detroit and other governmental entities of similar population and budget. We also obtained and assessed external audit financial data recorded in the county's general ledger system for the fiscal

years 2003-2008. We obtained other information and performed procedures considered necessary in order to address the engagement objectives.

To determine cost trends, we obtained information on external audit costs from both the private and public sectors including the Government Finance Officers Association and the American Institute of Certified Public Accountants. We made inquiries of management officials at Wayne County from various departments and agencies regarding specific contracts entered into for annual audit services. We discussed factors that may contribute to an increase in external audit costs with officials from the county's external auditors along with officials from the county's Financial Reporting Division. We also contacted other counties with similar population and budget aspects to Wayne County to determine their external audit costs. The fieldwork for the engagement was generally completed on November 2, 2009.

BACKGROUND

Annual Audit Required

The State of Michigan Public Act 2 of 1968, and as amended, requires the County of Wayne, and all other similar local units of government in the State, to file annual audited financial statements. The county's audit report is required to be submitted to the Michigan Department of Treasury on or before 180 days after the end of the fiscal year, or March 30th after the September 30th fiscal year end. In addition, the Wayne County Home Rule Charter 3.119(f) states the audit report should be completed within 120 days after the fiscal year end and provided to the County Commission. This section also requires copies of the audit report to be transmitted to the Chief Executive Officer, the Commissioners, and the State Treasurer, as well as be made available for public inspection.

The county's Comprehensive Annual Financial Report (CAFR) summarizes the county's financial activity, including audited financial statements (i.e., all funds and account groups including its component units). It provides the reader with an independent assessment and valuable information regarding the financial position and results of county operations. The CAFR includes all operations under the county's control including its various component units. It consists of three sections: introductory, financial, and statistical. Primary users of the county's annual CAFR are bond rating agencies such as Moody's, Fitch, and Standard and Poor's. These agencies determine their ratings of the county to a large extent based on financial data included in the CAFR.

The Wayne County Home Rule Charter 3.119(e) authorizes the county Legislative Auditor General, with approval of the majority of the commissioners serving, to contract with an independent external auditing firm to perform the county's annual financial audit or CAFR. The Charter requires the external auditor(s) to be a certified public accountant. It also states the term of the contract is to be established by the commission, but the first term shall be for not less than

three years and the auditor may not serve for more than eight consecutive years. The Office of Legislative Auditor General with the external auditor and the Department of Management & Budget work collaboratively to ensure the annual CAFR is completed timely.

Accounting for Annual Audit Cost

The costs for the annual audit are recorded in the accounting records in the following fiscal year. For example, the costs recorded in FY 2007 accounting records for external audit cost are actually for the FY 2006 audit. This lag is consistent with the county's accounting treatment for external audit costs and is allowable in accordance with generally accepted accounting principles.

Department of Management & Budget (M&B)

The Chief Financial Officer is the county official primarily responsible for maintaining the county's financial books and records and the preparation of the annual CAFR. Much of the responsibility for maintaining the books and records and compiling the CAFR has been delegated to the Financial Reporting Division of M&B. In that capacity the division is responsible for working with the county's external auditor and providing the numerous schedules and evidence necessary for the auditors to render their opinion on the county's annual financial statements.

RISK AND FACTORS RELATED TO EXTERNAL AUDIT COSTS

Objective (1)

Identify the risk associated with external audit costs and factors that determine the costs.

Risk

Risk in any area is dynamic and forever changing and this is certainly true for the unique risk associated with external audit costs. The primary risks associated with external audit costs are escalating and increasing annual audit fees and costs beyond normal and acceptable inflationary increases. However, there are numerous external and internal factors that determine and impact external audit cost.

External and Internal Factors

External Factors

The most dramatic and sweeping changes to external factors are primarily in response to fraudulent financial reporting experienced by some of the country's largest corporations, notably Enron and WorldCom in 2002. The sudden collapse of these two companies is largely responsible for the enactment of the Sarbanes-Oxley Act of 2002 (Act). That Act significantly

changed and increased the number of auditing standards and requirements for independent auditors regarding assurance or audit engagements. Initially it only impacted large for-profit businesses. But similar changes soon followed for governmental entities. The changes in the auditing standards now require an auditor to increase or expand aspects of the audit process. They included, but are not limited to: obtaining a better understanding of the entity's systems of internal control; increased audit planning and assessment of risk; performing in-depth examinations of certain documentation; and increased comprehensive testing of transactions. Collectively these changes all led to more audit hours and higher audit costs and fees.

As mentioned above, the most significant external factor can be attributed to the enactment of Sarbanes-Oxley. As a result, sweeping changes have been made to auditing standards over the last several years. Some of these standards became effective for audits of financial statements dated December 31, 2006, and after. These standards require auditors to:

- Comply with specific rules related to form, content, and extent of audit documentation.
- Formally communicate to governing boards matters they observe about accounting procedures and internal controls.

The other remaining new standards were effective for audits of financial statements dated December 31, 2007, and later. Eight of these new standards are known as risk assessment standards and significantly changed the procedures auditors must perform in all financial statement audits.

Specifically, these new standards require auditors to:

- More thoroughly examine and evaluate clients' accounting processes and controls, including the overall control environment, key controls over significant transactions, and the quality of internal oversight of the financial reporting process.
- Assess and document conditions in the clients' systems and processes that create risks of material misstatement in their financial statements, and identify what the client is doing to mitigate those risks.
- Perform additional testing in response to the risks of material financial statement misstatements.
- Design and perform more analytical tests of accounting and financial data.

These new standards have had an unquestionable effect on increasing audit costs and fees, but they also have brought some potential benefits as well. The benefits of these standards include improved documentation of the accounting procedures, processes, and systems. This could assist local government entities in identifying areas where related internal controls and processes need to be improved, which could lead to enhanced systems in the prevention and detection of fraud, waste, and abuse.

There were a total of 11 new auditing standards; according to a national study, these new standards were projected to increase the hours necessary to perform financial audits by 15 to 30 percent. The county's external auditors estimate the cost to implement the new auditing

standards could cause the county's audit cost to increase as high as $652,000 over the period of their recent contract.

Another important external factor is the number of local international accounting firms performing governmental audits in our market went from eight to four within the same timeframe as the Sarbanes-Oxley law was enacted. This reduction in the number of highly qualified auditors performing these types of audits significantly changed the competitive market conditions for this service. Ultimately, the number of international firms willing to perform government audits decreased to two during this period, only KPMG and Deloitte, resulting in even more challenges to the county to obtain the lowest possible price for external audit services, while also maintaining the name recognition of an audit firm that is so essential for the credit rating agencies.

The increase in the number of lawsuits and claims against audit firms after the failure of Enron, WorldCom, and other large corporations is another external factor that came into play during the period of our review. In response to the increase in lawsuits and claims, many of the large and prestigious audit firms elected to increase the number of audit procedures in an effort to have a more robust examination to mitigate this risk.

Internal Factors

Some of the most significant internal factors that affect audit cost are qualifications and experience of the financial reporting staff, quality and timeliness of work provided to the external auditor for examination, the thoroughness and completeness of accounting books and records, the adequacy of internal controls over financial reporting, and the attitude of senior management and the governing board toward fraud, waste, and abuse. The last item is sometimes referred to as the "Tone at the Top." A deficiency in any of these elements and/or others could lead to a determination by the external auditor that audit risk is high. A determination of high audit risk by the external auditor creates a situation where additional audit hours at rates up to $250 per hour are necessary and thus result in increased audit cost.

Based on a national survey, 29 percent of companies with one or more material weaknesses[1] in internal controls had fee increases that ranged from 100 to 200 percent. The Independent Budget Analyst office in California did a review of financial statement audit costs. Some key factors identified in their report that affect audit costs were:

- A local government's control environment including:
  - Integrity and ethical values
  - Governance
  - Management philosophies and operating styles
  - Financial reporting competencies
- The effectiveness of the local government's system of internal controls over financial reporting.

[1] A material weakness is defined as an internal control deficiency or combination of significant deficiencies that result in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

- Non-routine transactions and adjustments.
- Size and complexity of the local government (number of funds, stand-alone financial statements to be evaluated, and number of audit deliverables required).

Many of the internal factors noted above were also confirmed by the county's current external auditor as factors affecting the county's external audit costs. The official from the external auditing firm also indicated that the perceived risk is also a significant factor in affecting external audit costs. The official further indicated not having an entity-wide Code of Ethics or Hotline to report possible wrong-doing and the high volume of retroactive and sole-source contracts further contributes to increased perceived risk.

Observation(s)

The primary risk to the county as it relates to external audit costs and fees is escalating and increasing cost beyond normal inflationary increases. Many external and internal factors affect an entity's external audit costs and fees. Though many external factors affect the costs of annual audits, those factors are primarily outside the control of an entity. However, the county can strengthen internal controls over perceived risk to positively impact external audit costs and fees.

WAYNE COUNTY'S EXTERNAL AUDIT COSTS

Objective (2)

Determine and assess Wayne County's External Audit Costs and Perform Comparative Analysis.

For the fiscal years 2003 through 2008, Wayne County and its component units/agencies have spent $10.3 million for their annual audits. Specifically, over this period the county alone has spent over $8.2 million for the county's Comprehensive Annual Financial Report (CAFR), and just over $1 million in additional costs for the FY 2003 forensic investigation. The county's component units/agencies spent $1.1 million for its audits over this period. A summary table of the costs is below and a detailed table is contained in the appendix.

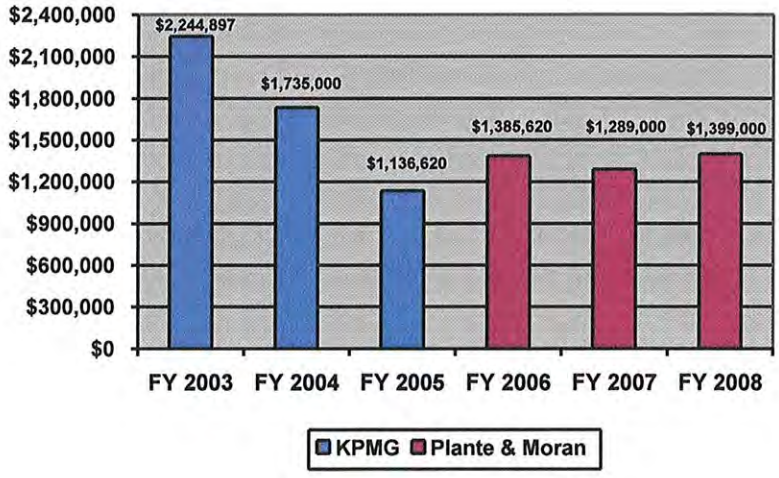
External Audit Costs
Wayne County and Component Units/Agencies
FYs 2003 – 2008
($ millions)

Agency	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	Total
CAFR & Related	$1.2	$1.7	$1.2	$1.4	$1.3	$1.4	$8.2
Forensic Audit and Related Costs	$1	0	0	0	0	0	$1
Sub-Total	$2.2	$1.7	$1.2	$1.4	$1.3	$1.4	$9.2
Component Units/Agencies	.03	.2	.2	.2	.2	$.2	$1.1
Total	$2.3	$1.9	$1.4	$1.6	$1.5	$1.6	$10.3

CAFR and Related Annual Audit Costs

For the six CAFRs that were completed during the period of our review, two external audit firms completed the work, KPMG and Plante & Moran. For FYs 2003 - 2005, the county's financial statements were audited by KPMG. In addition to the amounts paid to KPMG, an additional $1 million was paid for a forensic investigation due to discrepancies found in the FY 2003 financial statements. For FYs 2006 - 2008, Plante & Moran performed the financial statement audits. The total actual audit costs to complete the CAFRs and related items for FYs 2003-2008 was $9.2 million, see the graph below.

Actual Annual CAFR & Related Costs
Wayne County
FYs 2003-2008



Note: FY 2003 includes $1,004,897 in forensic investigation costs paid to other firms

CAFR & Related Audit Costs for Fiscal Years 2003-2005 (KPMG)

The annual audits performed by KPMG were initially contracted for $1.5 million for fiscal years 2003 through 2005. However, the costs almost tripled to over $4 million resulting in six modifications to the contract totaling $2,935,000 as shown in the table below. During this period of time the county experienced many challenges and the audited financial statements were not completed timely as required by state statute and county charter.

County's CAFR Audit Costs
KPMG
FYs 2003 - 2005

	FY 2003	FY 2004	FY 2005	Total
Initial Contract Price	$ 510,000	$ 530,000	$ 550,000	$1,590,000
Contract Modifications	$ 730,000	$1,205,000	$1,000,000	$2,935,000
Total Contract	$1,240,000	$1,735,000	$1,550,000	$4,525,000
Actual Amount Paid	$1,240,000	$1,735,000	$1,136,620	$4,111,620
Unspent Contract	$ 0	$ 0	$ 413,380	$ 413,380

CAFR & Related Costs for Fiscal Years 2006-2008 (Plante & Moran)

Beginning with the FY 2006 financial statements, the county issued a request for proposals. Plante & Moran was the successful bidder and was awarded the contract for the period of FY 2006 through 2008. Since Plante & Moran began performing the audit, audit fees have been relatively stable and the audit reports have all been completed and filed with the state of Michigan as required by state statute. Moreover, for fiscal years 2006 through 2008 actual amounts paid have been less than the contracted amounts, see table below.

County's CAFR Audit Costs
Plante & Moran
FYs 2006 - 2008

	FY 2006	FY 2007	FY 2008	Totals
Initial Contract Price	$ 1,450,000	$ 1,493,000	$ 1,539,000	$4,482,000
Actual Costs	$ 1,385,620	$ 1,289,000	$ 1,399,000	$4,073,620
Unspent Contract	$ 64,380	$ 204,000	$ 140,000	$408,380

In 2009, the commission approved another three year contract with Plante & Moran (P&M) to continue to serve as the county's external auditors through 2011, with an option for 2 additional and final years. The OAG's assessment of the contract indicated it has significant merits and represented a sound value to the county by identifying quantitative costs savings, especially compared to some other local units of government in our vicinity, such as the city of Detroit.

According to P&M's proposal, they estimate the county has or will save as much as $1.1 million in audit fees from 2006 through 2013, primarily as a result of entering into a long contract period. Entering into longer contract periods allows the auditor to spread certain costs over a longer period of time and some of those savings can be shared with the county. The following table identifies the contract amounts for the county's external audit for FYs 2009-2011.

County's CAFR Audit Contract
FYs 2009, 2010, and 2011
Plante & Moran

	FY 2009	FY 2010	FY 2011	Totals
Contract Amount	$ 1,486,000	$ 1,574,000	$ 1,663,000	$4,723,000

Wayne County Component Units/Agencies' External Audit Costs

In addition to the CAFR and related audit costs, the county has spent $1.1 million over the same period for audits of the financial statements related to component units/agencies such as the Pension Trust Funds, HealthChoice of Michigan, and the Detroit Wayne County Community Mental Health Agency (DWCCMHA). These audit costs have also grown exponentially from 2003 to 2008. Most of the increase in cost is related to DWCCMHA's audit; another factor is the increase in the number of component units during the period. The audits were performed by auditors in most instances other than the firm responsible for the county's CAFR. Generally half of the costs, and in some years more than half of the costs, for these audits is attributable to the separate audit of the DWCCMHA. Prior to fiscal year 2004, there was no separate audit of DWCCMHA; their audit was included with the county CAFR.

Moreover, the DWCCMHA is a fund of the county. Normally, funds do not have distinct or separately issued audited financial statements as does DWCCMHA. The business justification or other rationale for DWCCMHA to continue to have a separate audit is not clear, and having a separate audit may no longer be cost beneficial. We spoke to the county's external auditor about whether any cost savings could be achieved if the DWCCMHA audit was included with the county's basic audit. They indicated yes. They further indicated costs savings in a range of 12-24 percent of the separate audit costs could be realized. That equates to annual savings in the range of $15,400 to $35,000. If the separate financial statement audit of DWCCMHA was eliminated, the costs savings could be even more than what is shown above.

A summary of these audit costs is shown in the following table and a more detailed table is contained in the appendix.

Component Units/Agencies External Audit Costs
Wayne County
FYs 2003 – 2008

	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	Total
Total external audit costs	$33,750	$164,108	$208,588	$216,924	$223,604	$239,939	$1,086,913

Comparisons to Surrounding and National Local Units of Comparable Size

In order to assess the county's external audit costs we compared the costs to surrounding local units of government, as well as units of local government nationally of comparable size. We also compared the county's audit costs to the national trends.

Surrounding Local Units

We spoke to management officials at Oakland, Macomb, and Washtenaw counties to determine their audit costs over the last five years. We also compared our costs to those of the city of Detroit. We found since fiscal year 2003 other surrounding local units of government audit costs have consistently increased each year with the exception of Oakland County whose costs decreased from fiscal year 2004 to 2005 by $37,000. Collectively, the audit costs for all three surrounding counties are significantly lower than Wayne County's costs.

Even when adjusted for budgetary size, Oakland County's audit costs are significantly lower. Some of the reasons Wayne County's costs exceed Oakland's, per the external auditor representative who performs both audits, are Wayne County's perceived risk is higher and there appears to be a larger bureaucracy at Wayne County. Also, Oakland County has the benefit of having a flush discretionary or rainy day fund. The table below summarizes the audit costs for the surrounding local units of government.

Annual External Audit Costs
Comparison of Surrounding Local Units of Government
FYs 2003 – 2008
($ millions)

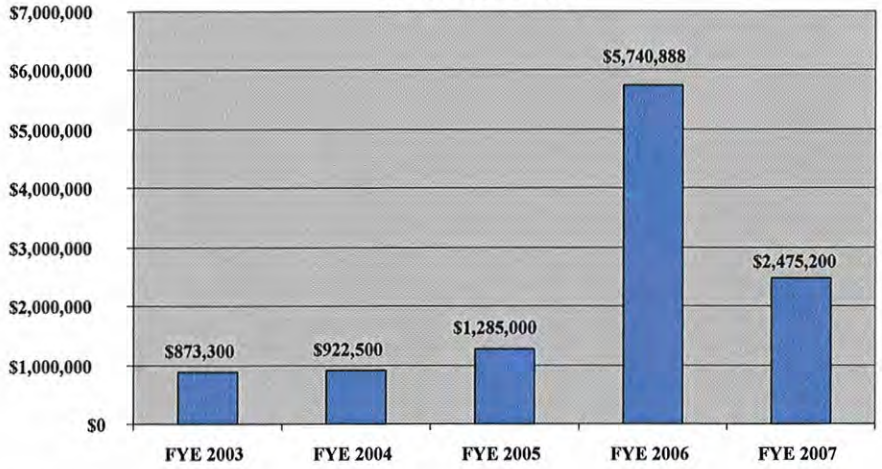
Local Government Unit	Budget FY 2008	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	TOTAL
Oakland County	$826 million	n/a	$ .227	$ .190	$ .196	$ .210	$ .208	$1.03
Macomb County	$476 million	n/a	.72	.77	.82	.94	n/a	3.25
Washtenaw County	$194 million	.108	.109	.111	.112	.114	.115	.670
City of Detroit	$3.1 billion	.873	.922	1.28	5.7	2.47	1.8 *	$13.0
Wayne County (CAFR)	**$2.3 billion**	**$1.2**	**$1.7**	**$1.2**	**$1.4**	**$1.3**	**$1.4**	**$8.18**

*Estimated

City of Detroit

We spoke to management officials at the city of Detroit Auditor General's Office to ascertain their annual audit costs for the last five years. The city of Detroit's budget for FY 2007 was $3.7 billion. The city's audits were performed by KPMG and as reflected in the chart above, their annual audit costs have increased significantly starting with fiscal year 2005. City officials explained that a large percentage of the increase in audit costs resulted from the city eliminating accounting positions and veteran and experienced staff retiring. As a result, remaining staff members were required to work significant overtime and less experienced outside contractors were hired to assist in preparing the financial statements for audit.

Annual Audit Costs
City of Detroit
FYs 2003-2007



National Comparisons

We compared the county's FY 2008 audit costs with other governmental units nationally of similar population size or annual budget amount. Based on our analysis, Wayne County's external audit costs are higher than all but one of the other national governmental units in our analysis. When compared on a per capita basis, the county's cost is higher than those in our analysis, see the table below.

External Audit Costs
Other Counties Across the Nation
FY 2008

Governmental Unit	Population	FY 2008 Budget	FY 2008 Audit Costs	Per Capita Basis
Broward County, Florida	1.7 million	$3.50 billion	$850 thousand	$ .50
Riverside County, California	2 million	$4.50 billion	$313 thousand	$ .157
Suffolk County, New York	1.4 million	$1.60 billion	$700 thousand	$ .50
Cook County, Illinois	5.3 million	$2.94 billion	$1.47 million	$ .278
Wayne County, Michigan	**2 million**	**$2.30 billion**	**$1.4 million**	**$ .70**

National Audit Cost Trends

An article in the CPA Journal, dated October 2006, indicated for years 2001 - 2004, total audit and audit-related fees increased 103 percent for 496 of the S&P 500 companies. Another reliable publication indicates that the median increase in audit fees between 2001 and 2006 was almost 350 percent, with the largest increase between fiscal years 2003 and 2004. From 2001 – 2004 the county's audit costs increased 348 percent, whereas from the period 2001-2006, the county's cost increased 296 percent, somewhat less than the national trend. Some factors that contributed to the county's increase in audit costs are discussed below.

Factors that Contributed to Wayne County's Increased Costs

It appears the county was caught in a perfect storm of circumstances that caused the costs of annual audits to increase exponentially during the period of our review. There were four primary factors that contributed to the county's increase in audit costs over this period. They are:

- A reduction in the number of qualified audit firms in our market performing government audits.

- The change in auditing standards. The increase in the number and complexity of new auditing standards required more audit work to be performed by external auditors.

- The need for and the results from the forensic investigation completed in 2005 which concluded management circumvented key controls in the financial reporting process for FY 2003, thus creating a higher audit risk environment at the county. This meant the county's audit risk and susceptibility for misstatement of financial reporting became extremely high, whereas prior to the forensic investigation it was considered much lower. As a result of the forensic investigation, more audit steps and procedures were deemed necessary by the external auditors to provide them with a level of comfort necessary in order to render an opinion on the financial statements. In addition, the same financial management team responsible for maintaining the books and records for FYs 2003 – 2005 largely remained in place until mid-2005. Not until that time was the Chief Financial Officer and other key financial reporting personnel in charge during the financial discrepancies were reassigned and/or replaced.

- The external auditor's perception of increased risk associated with the forensic investigation for FY 2003's financial statements. The forensic investigation created uncertainties as to the reliability and integrity of the county's financial reporting for fiscal years 2003 – 2005, which proportionally led to more testing of accounting records and transactions by the external auditors. This additional work translated into an increase in audit hours and cost.

As part of our analysis, we contacted an official from the county's current external auditor to discuss steps the county could take or consider in order to control audit costs based on our unique environment and circumstances. The official indicated one measure to control costs would be to bring all external audits (component units/agencies) under the umbrella of a single external auditor. The official added, in addition to reducing costs, you would also have

consistency in reporting along with improved engagement management to ensure all audit reports are completed in time to meet the State and county filing or completion deadlines.

Another factor the official believes contributes to the cost of audits here in the county is the perceived risk associated with the absence of a county-wide code of ethics and the volume of retroactive contracts that are approved by the county. The volume and the necessity for approving retroactive contracts have been recently discussed in the full commission meetings and much concern has been expressed regarding them.

The external auditor went on to say the county has taken significant steps to stabilize audit costs here in the county, and if the county continues to take steps to reduce the audit risk, the costs should remain stable and only be subject to increases caused by new standards and inflationary factors.

We also spoke to an official in the county's Financial Reporting Division about the county's audit costs. They indicated local governments' audit fees were extremely low prior to 2003. They stated governments had been benefiting from a price/fee break from the large international firms for quite some time because government audits took place in what was then referred to as their "down time" period where they could take a loss on a client in order to keep staff busy. However, after Enron, there was a period of growth in the public accounting industry which resulted in a reduction in "down time." With the advent of Sarbanes-Oxley, international firms began re-allocating their resources to performing Sarbanes-Oxley related compliance audit work which generated higher fees. During the same period of time, the pool of international accounting firms that audited governmental entities decreased from eight to four.

Code of Ethics and Hotline

Leadership in the county has not adopted a county-wide Code of Ethics or a Hotline. Though the CEO's inspector general maintains a hotline, the information obtained from that hotline is not shared with all key decision makers. As the county's external auditor indicated previously in this report, failure to establish and adopt a county-wide code of ethics and hotline are contributing factors to the high perceived risk of the county by an external auditor. A code of ethics and hotline send powerful messages to county employees, vendors, stakeholders, and citizens about the county's commitment to wipe out and mitigate risk, fraud, waste, and abuse.

Observation(s)

The county's external audit costs have certainly spiked from 2003's contract amount of $530 thousand to $1.6 million paid for the 2008 audit. Though the county's external audit costs are higher than those of surrounding counties, they are lower than those paid by the city of Detroit. When compared to local units of government and nationally of similar population or budget the county's per capita costs are again higher. Moreover, comparisons of audit cost are extremely challenging and difficult and may not provide the most meaningful analysis since audit costs are based on so many different factors and are unique to each entity's risk factors. Nevertheless, when the county's audit costs are compared to the national trends, the county's increase in costs is very comparable for the period of our review. Our analysis did determine that opportunities

exist for the county to enhance or strengthen policies, procedures, and internal controls to control future external audit costs.

Recommendation 2009-01

To control and possibly reduce the county's and the component units/agencies' audit costs, we recommend the Department of Management & Budget, Financial Reporting Division along with the component units/agencies consider the feasibility of contracting with a single external audit firm to perform all required annual audits for Wayne County.

Recommendation 2009-02 (A) and (B)

To control and possibly reduce the county's audit costs, we recommend the Wayne County Commission consider amending the charter and/or ordinance to:

(A) allow the external audit firm for the county to contract for a minimum of 5 years and not 3 years as the current law requires.

(B) remove or lengthen the period of time a single auditor can continuously serve as independent auditor from 8 years to 10 years.

Recommendation 2009-03

To control and possibly reduce the county's and the component units/agencies' audit costs, we recommend the Wayne County Commission require the DWCCMHA to provide a business and/or other acceptable justification and rationale why it requires a separate audit for its financial activity prior to approving any separate audit contract.

To reduce the county's perceived risk:

Recommendation 2009-04

We recommend the Wayne County Commission consider revising the procurement ordinance to establish stringent penalties and sanctions to management officials for the submission of retroactive contracts.

Recommendation 2009-05

We recommend the Wayne County Commission, Executive Branch, and all other County-Wide Elected Office Holders strongly consider the establishment of a county-wide Code of Ethics and Hotline.

Assess Management and Internal Controls Over External Audit Costs

Objective (3)

Assess Wayne County's Management and Internal Controls Over External Audit Costs

During the early fiscal years of our review period the county experienced many challenges to preparing and completing its financial statements. The annual audit was not filed by the required State of Michigan or county statute, charter, or ordinance deadline. However, mid-point through our review period the county, principally the Chief Financial Officer (CFO), took necessary and prudent measures to address the deficiencies that hindered the county from completing and filing its audited financial statements when required. These measures included fully implementing the corrective action plan (CAP) associated with the forensic investigation. The CAP called for a reorganization of the department and other measures, including but not limited to: staffing enhancements, staff trainings, re-engineering of key processes, and monthly financial closings and reporting.

It appears the corrective actions taken by the CFO not only allowed the county to become compliant with the state's filing deadline, but also contributed to the county's audit fees being stable from FY's 2006 through 2008. Moreover, the county's audit fees paid were less than the contracted amount in some measure due to the improved operations and effectiveness of the Financial Reporting Division.

However, another matter of concern relates to the county's continued ability to remain compliant with filing the annual audited financial statements timely and controlling the external audit costs when faced with turnover or retirement of key personnel in the Financial Reporting Division.

Observation(s)

Though the county had significant challenges in the early period of our review with preparing and filing its audited financial statements by the deadlines outlined in state statute and county charter and ordinances, they have generally eliminated or mitigated those challenges by the end of our review period. The measures taken by the CFO and her leadership team now appear sufficient to ensure the county's management and internal controls over external costs will result in the county's future costs in the area being stable and only subject to normal inflationary increases. To ensure the measures taken remain effective, the CFO and her leadership team must ensure the loss of key financial reporting personnel does not cause disruptions to the gains achieved in this area.

NOTEWORTHY ACCOMPLISHMENTS

The county and its financial reporting team should be commended for receiving the Government Finance Officer Association's Certificate of Achievement for Excellence in Financial Reporting three of the six years covered by our review. Also, the Chief Financial Officer and her team should be commended for taking appropriate actions after the forensic investigation to return the county to timely financial reporting and filing with the State of Michigan.

VIEWS FROM RESPONSIBLE OFFICIALS

The current audit fees are based on situations that existed in 2003. Since that time, as noted in the OAG's report, M&B has improved processes and procedures and now has an efficient financial reporting process which includes providing comprehensive audit support in a timely manner. These improvements alone warrant a decrease in audit costs. Given declining revenues throughout the state, it is reasonable that audit firms decrease fees to align with their client's ability to pay. Management and Budget encourages the OAG to approach the county's current external auditors in an attempt to realize cost savings.

CONCLUSION

During the period covered by our review, the county and its component units and agencies spent over $10 million for annual audits. This level of expenditure is certainly worthy of monitoring, controlling, and taking reasonable measure(s) to ensure the costs are as minimal as possible. Clearly the county had challenges with these costs early in our review period which saw the CAFR costs increase from a contract price of $530 thousand to $1.6 million paid from 2003 to 2008, respectively. The county's costs have been somewhat stable since 2006, and the costs decreased a bit from 2007 to 2008, in large measure due to the bold actions taken by the CFO to ensure timely and accurate financial reporting

We found many factors determined external audit costs, and the factors are both external and internal. Some external factors, to an extent are outside the county's control, such as the economic reality when fewer firms in our market area offer audit services. When this occurred, those remaining firms were allowed to increase their fees and they did. The increase in audit

standards during the period of our review, primarily in response to the corporate failures of Enron and WorldCom is also an external factor that affected our costs, but is outside our control.

But the county certainly can take measures to control and manage the internal factors that determine an entity's external audit costs. These factors, especially those that address the quality and competency of key personnel responsible for compiling the annual financial statements can certainly be addressed and managed by the entity. The county has taken significant measures to strengthen its capacities in this area. We also found because the county was subject to a forensic investigation and that management override was determined to be the cause for financial reporting irregularities was another factor that contributed to the county's spike in these costs.

The county's costs for these services are higher than those of our surrounding counties for many reasons. Even when we compared the county's cost to other counties nationally of similar population or budget, the county's cost was higher. Though we recognize comparability is very difficult to achieve, when the county's cost increases are compared to audit cost increases overall, the county's increase is somewhat less than the national average for the period of our review.

We implore county officials to seriously consider implementing the recommendations contained in this report to ensure the county's costs in this area remain stable and as minimal as possible. The appropriate county official(s) will be requested to provide a corrective action plan within 30 days after the approval of this report by the full commission.■

This report is intended solely for the information and use of Management & Budget and the Wayne County Commission and is not intended to be and should not be used by another other than these specified parties. This restriction is not intended to limit the distribution of the report, which is a matter of public record.

Willie Mayo, CPA, CIA, CICA
Auditor General

Appendix

Annual External Audit Costs
County of Wayne
Fiscal Year End 2003- 2008

Annual External Audit Costs
Wayne County and Component Units
Fiscal Year Ended 2003 through 2008

Type/Audit Firm	Department/Agency	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	Total
CAFR & Related Audits								
KPMG	OAG	$1,240,000	$1,735,000	$1,135,620	n/a	n/a	n/a	**$ 4,111,620**
Plante & Moran	OAG	n/a	n/a	n/a	$1,385,620	$1,289,000	$1,399,000	**$ 4,073,620**
	Subtotal	**$1,240,000**	**$1,735,000**	**$1,135,620**	**$1,385,620**	**$1,289,000**	**$1,399,000**	**$ 8,185,240**
Component Units/Agencies Audits								
Alan Young & Assoc.	Det. Wayne County Mental Health Agency	**	$119,958	$135,614	$135,614	$135,794	$135,794	$ 662,774
George Johnson & Co.	Pension Trust Funds	$28,050	31,150	32,700	34,050	37,800	43,450	$ 207,200
George Johnson & Co	DWC Stadium Authority	5,700	5,450	5,450	6,050	6,400	n/a	$ 29,050
Plante & Moran	DWC Stadium Authority	n/a	n/a	n/a	n/a	n/a	6,900	$ 6,900
Reznick Group	WC-Detroit Comm. Dev. Entity, Inc.	*	*	10,000	10,400	10,920	10,920	$ 42,240
Alan Young & Assoc	WC-Economic Dev. Corp.	**	**	3,500	3,240	3,402	7,050	$ 17,192
Alan Young & Assoc	Metro. Growth & Devel. Corp.	*	*	7,344	6,480	6,804	10,725	$ 31,353
Alan Young & Assoc	HealthChoice of Michigan	***	7,550	7,850	8,400	8,850	8,850	$ 41,500
Alan Young & Assoc	Regional Jobs and Economic Growth	*	*	3,250	3,240	3,402	6,750	$ 16,642
Alan Young & Assoc	Dev. Corp. of Wayne County	*	*	*	2,880	3,042	6,000	$ 11,922
Alan Young & Assoc	Housing & Community Dev. Corp.	***	***	2,880	2,880	3,500	3,500	$ 12,760
Alan Young & Assoc	Brownfield Redevelopment Corp.	**	**	**	3,690	3,690	**	$ 7,380
	Subtotal	**$33,750**	**$164,108**	**$208,588**	**$216,924**	**$223,604**	**$239,939**	**$ 1,086,913**
Forensic Investigation								
Clark Hill	OAG/Corporation Counsel	135,494						$ 135,494
Howard & Howard, PC	OAG/Corporation Counsel	752,454						$ 752,454
Bodman, LLP	OAG/Corporation Counsel	116,949						$ 116,949
	Subtotal	**$1,004,897**						**$ 1,004,897**
Grand Total		**$2,278,647**	**$1,899,108**	**$1,345,208**	**$1,602,544**	**$1,522,604**	**$1,638,939**	**$10,277,430**

* Component Unit not in existence
** Component/Agency Audit Not Performed
*** Not able to obtain