



# Preparing cities for the Municipal Oversight law change

By David A. Vaudt, CPA

*A law passed during the 2012 Legislative Session will change the oversight of cities with a population of fewer than 2,000 starting on July 1, 2013. This article will explain the changes and outline how the affected cities should prepare for these changes.*

## **Current law**

Under current law, cities of 2,000 or more in population are required to be audited annually, while cities with populations from 700 to 2,000 are required to be audited once every four years. Cities with populations fewer than 700 are not required to be audited except by citizen petition or as required by the Single Audit Act Amendments of 1996 and the Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations (Single Audit). Cities may hire the State Auditor's Office (AOS) or, through a request for proposal (RFP) process, a certified public accounting (CPA) firm to conduct their audit. Cities must file their audit report with AOS and pay a filing fee.

In recent years, small city frauds have been on the increase. When comparing a six-year period ending in 2011 with the previous six-year period, reported frauds in cities fewer than 700 in population increased more than 350 percent. It was clear the current system of oversight was not working. A new system was needed to limit the opportunity for fraud by providing a level of oversight, but also needed to be economical for small cities.

## **Law change**

With those goals in mind, the law was changed to provide oversight of all cities. To allow cities to budget for the new examination requirements, the law will not take effect until July 1, 2013. Under the new law, an annual audit will continue to be required for cities of 2,000 or more in population. However, the four-year audit requirement will cease for cities between 700 and 2,000. Instead, cities with populations fewer than 2,000 will be required to have annual or periodic examinations, the frequency of which is based on budgeted expenditures. (However, all cities will continue to be required to have a Single Audit performed in any year the city expends \$500,000 or more in federal awards.)

An examination is a set of procedures narrower in scope than

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an audit, but also with less cost than an audit. Rather than focusing on auditing the financial statements of a city, the examination is designed to focus on the financial processes of a city to help ensure accountability and compliance and minimize the opportunity for fraud.

Cities with \$1 million or more in budgeted expenditures in two consecutive years will be required to have an **annual** examination. (The requirement for two consecutive years ensures cities with one-time surges in expenditures continue to be treated as periodic examination cities.) As with annual audit cities, these annual examination cities may hire AOS or, through a RFP process, a CPA firm, to conduct their examination. Annual examination cities must pay for their examination and the statutory filing fee to file their examination report with AOS. The filing fee will be used to pay for development of sample reports and examination programs used by AOS and CPA firms performing annual examinations.

Cities not required to have an annual examination will pay a periodic examination fee each year to AOS to cover the costs of a **periodic** examination. Under the law, a periodic examination will be required at least once every 8 years, but may be done more frequently. AOS will administer the periodic examinations, including the RFP process to select CPA firms. If a periodic examination city elects to have an annual audit or examination, the city would not be subject to the periodic examination fee.

## **Budgeting for the new law**

Cities with a population of 2,000 or more should continue budgeting for an annual audit. Cities with fewer than 2,000 population should budget for either the costs of an annual examination or the periodic examination fee. The original certified budget for the fiscal year subject to examination is used to determine whether the examination will be annual or periodic. For example, for the

annual examination conducted in fiscal year 2014, the determination will be based upon the original fiscal year 2013 budget certified in March 2012. (Cities with \$1 million or more in budgeted expenditures in fiscal year 2013 will need to also consider the original fiscal year 2012 budget to determine whether they have two consecutive years with \$1 million or more in budgeted expenditures.)

**Cities with a population fewer than 2,000 and under \$1 million in budgeted expenditures (or \$1 million or more in expenditures for only one year)**

For periodic examination cities, fees will be set by administrative rule. Working with the Iowa League of Cities, AOS determined the following periodic examination fee structure in order to execute the statutorily required periodic examinations. The fees are based upon budgeted expenditures.

Periodic Examination Fee Structure	
Under \$50,000	\$100 fee
At least \$50,000 but less than \$300,000	\$475 fee
At least \$300,000 but less than \$600,000	\$900 fee
At least \$600,000 but less than \$1,000,000	\$1,200 fee

Periodic examination cities should budget to pay the yearly fee to AOS starting with the fiscal year 2014 budget. Periodic examination fees will be due March 31, 2014.

**Cities with population fewer than 2,000 and \$1 million or more in budgeted expenditures for two consecutive years**

Cities meeting the requirement for an annual examination should budget for the cost of an annual examination starting with the fiscal year 2014 budget. The number of hours and hourly rates to complete an annual examination will vary. Recent CPA firms' average hourly rates for four-year city audits ranged from \$35 to \$157 per hour, and the average AOS hourly rate is \$52 per hour. Additional examination costs cities will incur include AOS or CPA firm travel expenses and the statutory filing fee payable to AOS.

While a specific timeline for annual examinations is not set by the *Code of Iowa*, the following is a suggested timeline:

Timeline for Annual Examinations	
January-March 2013	Include the estimated annual examination cost in your fiscal year 2014 budget.
By September 1, 2013	Contract for annual examination services by hiring AOS or, through a RFP process, a CPA firm. To assist cities with the RFP process, AOS will publish a sample RFP in Spring 2013.
July 1, 2013-March 31, 2014	Fiscal year 2013 annual examination should be performed and filed with AOS.

**Conclusion**

The new municipal oversight law represents a good opportunity to strengthen oversight of small cities. All cities want to do the right thing for their citizens. The new law will give them unprecedented, affordable access to the expertise needed to help ensure they are operating effectively. While conducting annual and periodic examinations, CPA firms and AOS will identify changes cities can make to their operations to help increase accountability and compliance and reduce the opportunity for fraud. With advance planning, cities can ensure smooth transition to the new requirements.

*David Vaudt is Iowa's State Auditor and began his third four-year term in January 2011. More information on the State Auditor's Office can be found at [auditor.iowa.gov](http://auditor.iowa.gov).*



**Update**

*The Iowa Public Agency Investment Trust is a jointly sponsored program for members of the Iowa League of Cities, the Iowa State Association of Counties and the Iowa Association of Municipal Utilities.*

**As of December 20, 2012**

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