

SARBANES-OXLEY AND THE PUBLIC SECTOR

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I. INTRODUCTION: Major parts of presentation

- “Trickle-down” effects of Sarbanes-Oxley on state and local governments (“SOX Creep”)
- Trends we see
- Increased accountability expectations of governing bodies and the public

II. VIRCHOW KRAUSE’S ROLE IN SERVING STATE AND LOCAL GOVERNMENT CLIENTS

- Accounting and auditing
- Financial, management, and operations consulting: to help clients provide cost-effective services in balancing competing demands of high/quality services and affordable taxes (to “do more with less”)
 - Management audits (organization, management, technology, & staffing)
 - Operational efficiency reviews
 - Agreed-upon-procedures reviews
 - Process improvement and re-engineering
 - Budget, revenue, and program analysis
 - Consolidation feasibility and shared services analysis
 - Performance improvement

- Cities & Villages
- Counties
- State Agencies
- School Districts
- Utility Districts (water, sewer, and electric)
- Other special districts
- Colleges and Universities

- Primarily in Wisconsin, Illinois, Minnesota, and Michigan but have served clients in 34 states

- This role played long before Sarbanes-Oxley enacted

III. GAO Auditor Independence Standards Regarding Non-audit services for yellow book clients

- Promulgated in July 2002 after draft issued in January 2002, in same month as passage of Sarbanes-Oxley
- Followed SEC Chairman Arthur Levitt's push for similar proposed SEC standard that was incorporated into Sarbanes-Oxley
- Two overarching principles
- Services not in compliance with standard: bookkeeping, actuarial services, financial information systems design and implementation, appraisal/valuation, human resource management functions
- Not difficult to comply with

IV. TRENDS WE ARE SEEING: NOTHING NEW TO YOU

- Tax caps and property tax limits; especially difficult for school districts with declining enrollments and municipalities with slow growth in property values; at worst may lead to dismantling of some existing jurisdictions

- Attempts to adopt Taxpayers Bill of Rights (TABOR)
- Significant staffing reductions at all levels
- Public wanting it both ways (high services and low taxes) and resulting unwillingness of elected governing bodies to resolve controversial issues
- Mismatch between revenue required and service levels approved → mediocre services and unsatisfied constituents
- These trends are not directly related to Sarbanes-Oxley, just occurring at the same time
- In addition, seeing little if any of our clients asking for 404-type work

V. GOVERNING BODY EXPECTATIONS REGARDING ACCOUNTABILITY

- Large clients
- Small clients
- Well-run clients
- Clients facing financial or operational crises
- Clients have operations reviews of 1 or 2 departments per year to achieve cost savings
- RE 404 type work, overall we have 4 or 5 out of 540 audit clients with internal audit functions (larger counties); don't see municipalities under population of 75,000 even remotely interested
- Governing body elected officials who work for publicly traded companies who work in Sarbanes-Oxley climate
- Skeptics who are new to state and local government elected governing bodies who start from the premise that government is

replete with fraud, waste, and abuse and that their role is to eliminate it (things are messed up and need fixing)

- Expectation is “show me that it is not the case”
 - Best practices
 - Benchmarks few
 - Accountability and transparency reinforced by Sarbanes-Oxley
- Same elected governing body members are quick to say: don't reduce services but do more with less → forced efficiencies through disapproval of revenue increases (expect accountability but are unwilling to make tough choices – reflect their constituents well)

VI. GAZING INTO THE CRYSTAL BALL: WHAT I EXPECT IN THE FUTURE

- Further “trickle-down”
- Increased mandated financial reporting requirements to gain greater degree of transparency following upon GASB 34, GASB 45, etc. – expect push back from GFOA, especially in S.E.A area
- Difficulty, there are few benchmarks in state and local government finance and management because of vast differences in service levels and delivery methods, sophistication of management, and public expectations
- We see bigger local governments (City of Chicago, Chicago Public Schools, City Colleges of Chicago, Naperville) gearing up to do 404-related risk assessment/internal audit work
- Questions will be raised: are the costs of Sarbox-related initiatives applied to state and local government worth the benefits?

- Fraud: pressure/need, opportunity, rationalization (embezzlement most often related to gambling addiction)
- State and local government will be expending more energy in demonstrating that they are providing services to the public in a cost-effective/efficient manner
- Inevitable squeeze: mandated costs of doing more in this area at the same time trying to reduce or stabilize program service funding requirements