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# State Comptroller: "New Jersey audit system deeply flawed"

## Report finds serious problems with New Jersey's system of external audits; calls for substantial changes.

New Jersey State Comptroller Matthew Boxer called Tuesday for fundamental and crucial changes in the way government entities throughout the state hire outside auditors.

A report released by the State Comptroller's Office surveyed government units in the state and reveals significant flaws in the way public entities are selecting and using external audit firms.

New Jersey law requires that all government units hire an external auditor to perform an annual audit of the unit's books, accounts and financial transactions. External auditors are a primary source of oversight for the spending of billions of taxpayer dollars in New Jersey each year. Public entities spend millions of dollars specifically on annual contracts with external auditors.

The study conducted by the Comptroller's Office shows hundreds of public entities have not followed professional guidance by hiring auditors without using a competitive selection process and by retaining the same auditor for decades on end. The ramifications for the independence and quality of external audits in New Jersey are significant.

"There is no practical or feasible way that centralized oversight can be imposed on the 1,900 separate units of government in New Jersey, so external audits are crucial in this state," Boxer said. "When those audits are not performed effectively, money gets wasted. Moreover, the public gets a misleading picture about the financial health of their government."

Boxer called on all government entities in New Jersey to:

- hire external auditors through a competitive selection process at least every five years.
- replace the auditor with a different firm at least every 10 years.
- refrain from hiring any audit firm that made political contributions on the local or state level in the previous year.

The report also recommends the state Legislature consider legislation making these practices mandatory.

The survey looked specifically at the following three areas:

**Auditor Rotation**

According to the survey, close to 400 government entities in New Jersey have retained the same external auditor for more than a decade and, in 19 instances, for four decades or more. Two government entities have had the same external auditor for more than 60 years. Professional literature has described the serious negative effects that such an absence of auditor rotation has on an audit.

As part of its review, the Comptroller's Office compared the annual audits of 22 school districts to subsequent court-ordered reviews of these districts performed by KPMG, LLP and Wiss & Company, LLP. The results reflected an alarming disparity in findings, with the greatest disparities occurring in school districts that kept the same auditor for 10 years or more. In one case, the initial external auditor identified a school district as "low risk" with no control deficiencies, while the subsequent review identified the district as "high risk" and cited 60 deficiencies.

**Competitive Selection Process**

The survey shows close to 400 public entities, and likely more, hired their audit firms without any competition.

A competitive contracting process includes public advertisement of the contract, upfront establishment of selection criteria, written evaluation and ranking of proposals, and public reporting on the results.

Awarding a contract through non-competitive assignment is particularly problematic in the case of audit work, where the vendor is performing an oversight role in which independence is critical. The federal government requires that a competitive process be used for federally mandated audits.

"Too few New Jersey government units are selecting and rotating their auditors in a way that is in the best interest of New Jersey taxpayers," Boxer said.

**Political Contributions**

The Comptroller's report also details that the 10 audit firms with the largest number of government clients made political contributions exceeding $1 million during 2006 and 2007. Conversely, of the 18 firms in the survey with the fewest number of clients, only one made a political contribution. Boxer said the merits of a contract proposal, not the level of political contributions, should be the primary factor in selecting auditors.

"Financial oversight in New Jersey should not be left to firms that have obtained that role through contributions to the political structure they are supposed to be overseeing," Boxer said.

The Comptroller's Office plans to provide assistance to all public entities in using best practices when selecting and using external auditors.