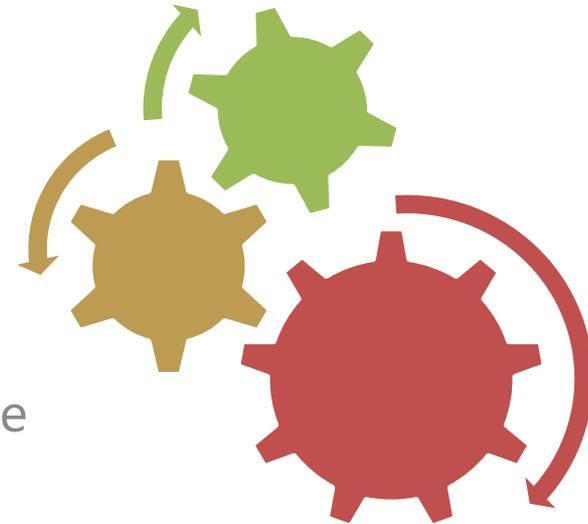


Practicing Effective Internal Controls Sheriff Office & Jail

Prepared by
The University of Tennessee
County Technical Assistance Service
2016



Purpose of Class

- Provide an overview of the five components of the internal controls framework (theory).
- Expand on the principals of each of these components to assist you with being able to enhance your office's internal controls (application).
- Help you comply with amendment to T.C.A. § 9-18-102(a) as well as new federal grant requirements.

Housekeeping Notes

- Pre/post test
- Breaks and location of bathrooms
- Need special accommodations?
 - Please let us know!
- Don't be bashful, ask questions
- Any questions before we do Pre-Test?

Pre-Test



What are Internal Controls?

U.S. Government Accountability Office
(GAO) The Green Book Definition:

Internal control is a process effected by an entity's oversight body, management, and other personnel that provides reasonable assurance that the objectives of an entity will be achieved.

Source: COSO, GAO Greenbook, Para. OV1.01

What is an Internal Controls System?

“An internal controls system is a continuous built-in component of operations, effected by people, that provides reasonable assurance, not absolute assurance, that an entity’s objectives will be achieved.”

Source: COSO, GAO Greenbook Para. OV1.04

What is the COSO?

- The Committee of Sponsoring Organizations of the Treadway Commission created in 1985. *(Named after James C. Treadway Jr. Exec. Vice President – Paine Webber Incorporated and former Commissioner of the Security and Exchange Commission (SEC)).*
- COSO was formed due to questionable corporate political campaign finance practices and foreign corrupt practices in the mid -1970s, the [U.S. Securities and Exchange Commission](#) (SEC) and the [U.S. Congress](#) enacted campaign finance law reforms and the 1977 [Foreign Corrupt Practices Act](#) (FCPA) which criminalized transnational bribery and required companies to implement internal controls programs.

What is COSO cont.?

- Joint initiative of 5 private sector accounting/internal audit/management organizations that is dedicated to providing thought leadership through the development of frameworks and guidance on enterprise risk management, internal controls and fraud deterrence.
- AAA (American Accounting Association)
- AICPA (American Institute of Certified Public Accountants)
- FEI (Financial Executive International)
- IIA (Institute of Internal Auditors)
- IMA (Institute of Management Accountants)

COSO cont.

COSO prepares thought papers on the following topics:

- *Governance & Operational Performance*
- *Internal controls*
- *Risk Management*
- *Fraud Deterrence*

T.C.A § 9-18-102(a)

- An amendment to State Law requiring all county governments to establish and maintain internal controls which provide *reasonable* assurance that...
 1. Obligations and costs are in compliance with applicable law
 2. Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and
 3. Revenues and expenditures are properly recorded and accounted for to permit the preparation of accurate and reliable financial and statistical reports and to maintain accountability over the assets.

**Law takes effect June 30, 2016!
Must have systems in place by then.**

Why Do County Governments Need Internal Controls?

- a) Reduce opportunities for fraud and waste
- b) Help management make better informed decisions
- c) Establish performance standards
- d) Helps ensure compliance with applicable laws, regulations, policies, and procedures
- e) Eliminate adverse publicity
- f) Protect county assets
- g) Promote effectiveness and efficiency of operations
- h) Ensure reliability of financial reporting
- i) Promote transparency and accountability

Enhanced Single Audit Requirements for Federal grant recipients

- Auditors will be required to focus more on internal controls of grant recipients dealing with:
 - purchasing (including bidding procedures)
 - conflict of interest policies
 - sub-recipient grant monitoring
 - cost principals for personnel and indirect grant costs
 - financial reporting

OMB Super Circular, Audits of States, Local Governments and Non-Profit Organizations.

<https://nonprofitquarterly.org/2015/07/29/explain-the-omb-super-circular/>

Non-Compliance with this Amendment to State Statute

- State Audit's position is that they will document non-compliance with an audit finding (remember, this is now a State Statute, not just an auditing standard).
- If non-compliance is egregious enough, then this can impact State/Federal grant eligibility and payments.
- Potential negative impact on county bond rating (rating agencies will be asking about your documented internal controls processes during upcoming rating calls).

SEC Rating Call Question

"...Please elaborate upon the process of your identification and remediation of the material weakness in internal controls over financial reporting. Include as part of your response a sufficiently detailed timeline that lays out your course of action. Specifically identify in this timeline when the deficiency was identified, when management concluded that the deficiency resulted in a material weakness, when a remediation plan was developed and implemented including its documentation, communication, and any testing..."

From SEC Comments and Trends, An Analysis of Current Reporting Issues, 2014.

Case Study

**Rita Crundwell, City Treasurer
Dixon, Illinois**



Poor internal controls = Opportunity for FRAUD

Dixon, Illinois



Dixon, Illinois

- Small, rural town in Illinois, with 16,000 population two hours west of Chicago.
- City has annual operating budget around \$8,000,000.
- City was audited annually by CPA firm, clean audits with no instances of noncompliance.
- Fun fact: Dixon was the boyhood home of President Ronald Reagan.

Rita Crundwell

- Had been a trusted city employee for over three decades.
- Education: High School Diploma.
- How people described her... "Sweet as pie", "Couldn't find a nicer person",
- One of the City Councilmen described Rita as "The biggest asset to the city as she looks after every tax dollar as if it were her own"

The Crime

- Rita stole ***\$53,000,000*** (Ranked the largest municipal fraud and 5th largest fraud of any kind in U.S. history).
- Fraud occurred over a 20 year period.
- Her annual salary was \$80,000.
- However, she owned over 400 of the finest quarter horses in the country with names like "I'm Money Too" and "I Found a Penny"...

How She Did It...

- No segregation of duties over keeping the accounting records and disbursing funds. Everyone trusted her!
- City already had a Capital Development Fund at a local bank.
- She opened a separate bank account under the city's name called the "Reserve Sewer Development Construction Account".
- She wrote checks from the Capital Development Fund to the Treasurer. She then deposited those funds into the Reserve Sewer Fund.
- She was only authorized check signer for account, she alone reviewed/reconciled all city bank statements and the side bank account was not recorded on city general ledger.

Money from Taxpayers to Rita

- Rita created 179 fictitious construction invoices from IDOT and disbursed funds from regular city accounts to the side bank account.
- She would then draw funds from the side account for personal use.
- In 2009 she embezzled \$5,600,000.

INVOICE

No Logo



FAKE INVOICE

INVOICE NO. 78947
RESP. CODE 8040
INVOICE DATE 11/15/03
REVENUE CODE 6305
AUDIT NUMBER
PAYER NUMBER 06614

DIXON, CITY OF
C/O City Clerk
City Hall
Dixon
IL 61021

EXPLANATION OF CHARGES

PAY FROM THIS INVOICE

Misspelled



LOCATION: Route 26 & South Galena Avenue
LOCAL SECTION:
ROUTE : FA316
SECTION : 101RS-3
COUNTY : Lee
JOB NO. : P-92-105-98
PROJECT NO.: FAS-02-39-02/000
CONTRACT NO.: 64362

397 - 11/24/03
alch 720037

The Agreement executed between DIXON, CITY OF, and the State of Illinois provides that the city will reimburse the state for part of the construction costs.

CITY SHARE: \$1,250,000.00

Bal. 235,000

Round Dollar Amounts



Upon Award

NOW DUE \$500,000.00

No Phone #



PLEASE MAKE CHECK PAYABLE TO TREASURER, STATE OF ILLINOIS
AND MAIL TO: Illinois Department of Transportation
Room 322, Harry R. Hanley Building
2300 So. Dirksen Parkway
Springfield, IL 62764

Where Dixon's Tax Money Go?

Where the City of Dixon's money went for the five months ending February 2012:



*According to FBI allegations. Spending amounts are from the fiscal year 2011-12 budget restated by the City of Dixon in September; they assume that budgeted amounts were in fact spent and pro-rates them over the five-month period.

SOURCES: Federal Bureau of Investigation, City of Dixon, *Chicago* estimates

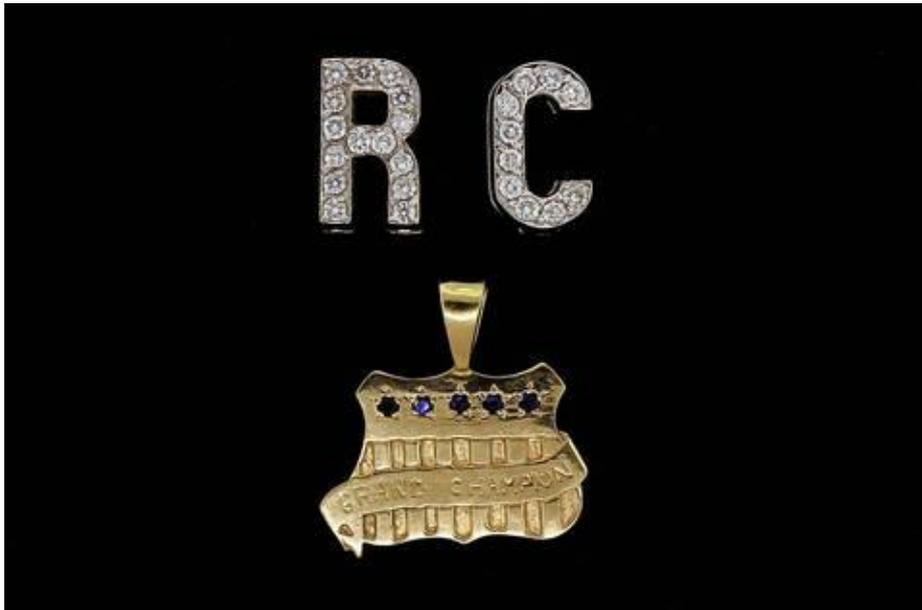
What did Rita buy with \$53,000,000?



400 Quarter Horses



228 Pieces of Jewelry



Rita's Florida Home



How Rita Was Caught

- In the fall of 2011, Rita took an extended vacation.
- A city clerk employee responsible for overseeing the city finances while Rita was gone requested all of the bank statements.
- The employee noticed the Reserve Sewer Account and notified the mayor who in turn contacted the FBI.
- The FBI conducted their own investigation and in the Spring of 2012 arrested Rita and charged her with defrauding the City of Dixon and misappropriating over \$30,000,00 from 2006 to 2012.

Where Were the Auditors???!?!!

- The CPA firm that did the city's audit had been the city's auditor for *over 20 years*.
- The auditors had also been doing Rita's personal tax returns for over 20 years on the side.
- The fraud was additionally caught by a "fill-in" bookkeeper by accident while Rita was on vacation.
- City attorney accused auditors of "gross negligence".

Financial Damage to the Community

- Total Embezzlement: **\$53,000,000**.
- CPA firms agreed to a payment of **\$36,150,000** in lawsuit settlement with city. Auditors released statement taking a share of the responsibility for the fact that the fraud was not detected.
- The city's bank settled in lawsuit for **\$3.85** million.
- U.S. Marshall Service seized Rita's property and assets and sold for around **\$10,000,000**.
- The City incurred **\$10,000,000** in legal fees.
- In the end, the City still lost **\$13,000,000** from the fraud.

Rita's Fate:



Rita's Fate cont...

- 19.5 years in a lonely Minnesota Federal Prison Cell. *Release date March 5, 2030.*
- Lost her home, assets, EVERYTHING
- She is now a **Convicted Felon.**
- She is serving as our training example today for what can happen to your county...

Fallout on the Community

- City endured operating deficits and budget cuts for years while fraud was occurring. Rita's excuse to council...cuts in State funding.
- City police chief informed by Rita there was no money available for emergency vehicle and equipment replacement due to drop in revenue (she had purchased a motor home for \$2.1 million).
- City endured layoffs and hiring freezes over the course of the embezzlement.
- The city pool was closed for years..."lack of" maintenance funds.

Moral of the Story...

Trust or independent auditors are NOT internal controls!

Establish and maintain sound internal controls for your office.

Remember...You can delegate authority, but you cannot delegate responsibility

One final fallout: Bad publicity for Mayor & City Council *(He is no longer the Mayor)*



Saturday, January 25, 14

Where is the City Today?

- Dixon used \$20 million of the settlement to shore up the city's reserves.
- Just completed a \$6 million downtown redevelopment project with monies from settlement.
- City general fund had a \$2,900,000 operating surplus in fiscal year 2015...after years of financial "woes"! Isn't it amazing what a little management oversight of spending and internal controls brings about?

Dixon *now* has internal controls and segregation of duties

Lets take a 15 Minute Stretch Break!



Who is Responsible for Establishing Internal Controls?

County Management (*elected/appointed officials*) are responsible for:

design, implementation and maintenance

of *adequate* internal controls over the office/department in which they are elected/appointed.

T.C.A. § 9-18-102(a).

But isn't it the State Comptroller's responsibility to detect fraud and internal controls weaknesses?

Note...Auditors tested internal controls during their annual audit of the county's financial statements, *and....*

...Auditors write hundreds of findings each year concerning internal controls weaknesses, *and....*

...they are not expressing an opinion on the effectiveness of the internal controls over county assets....effective internal controls is management's responsibility, *however...*

...The published audit report actually includes a disclaimer of auditor's opinion on whether the county operation's internal controls are effective or not.

A Point about Auditors and Fraud Detection...

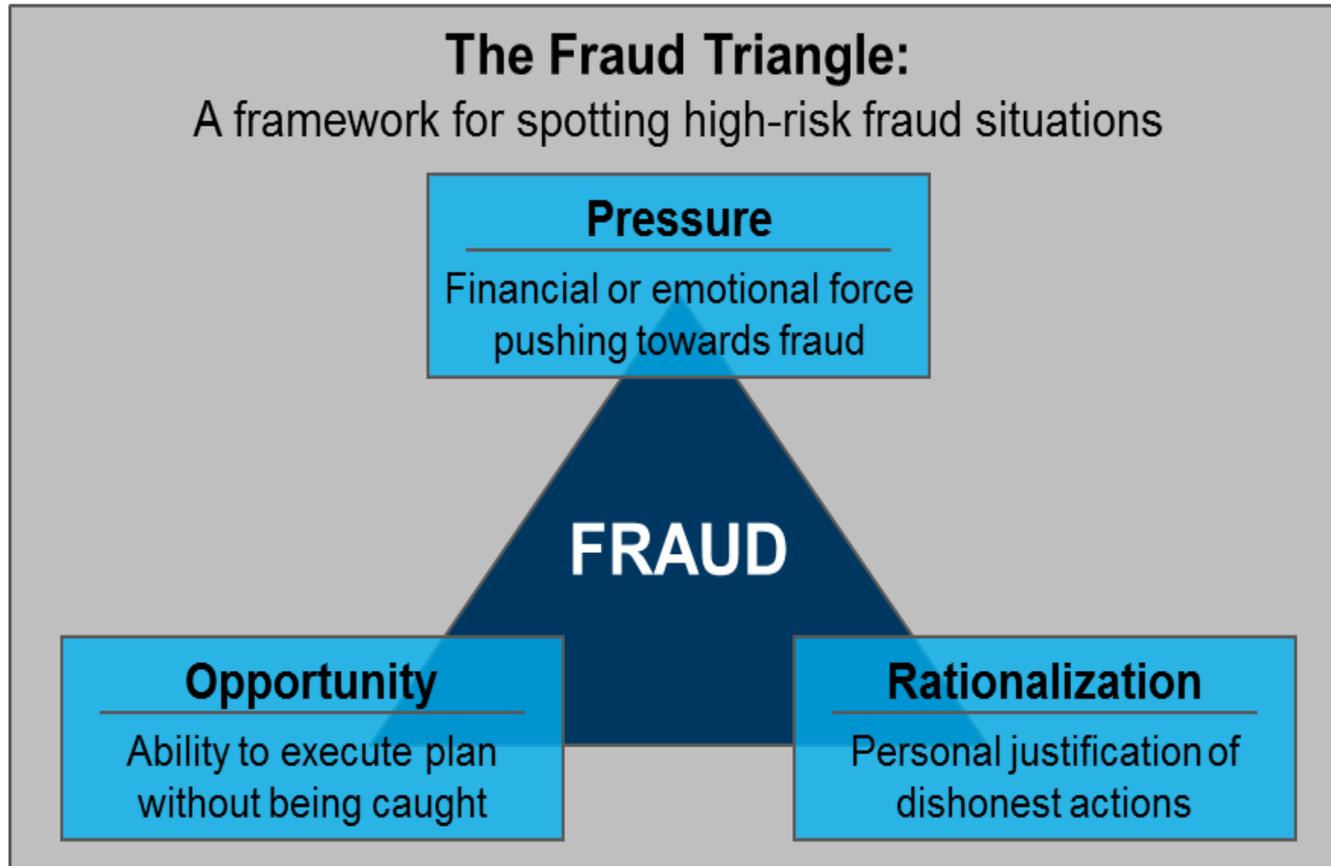
- Per the 2014 Annual Report to the Nations from the Association of Certified Fraud Examiners (ACFE), external auditors (performing routine annual audits) were responsible for detecting less than 5% of identified occupational fraud.
- Per same report, more fraud was identified by ***accident*** than by the external annual financial and compliance auditors.



Nobody Hires a Crook

- Per same ACFE 2014 annual report:
 - 87% of fraudsters had no criminal background and less than
 - 7% of employees committed the fraud they were caught for in the first year of employment.
 - The largest frauds were perpetrated by individuals employed over 10 years.
- Takeaway...
 - Pre-employment criminal background checks are good practices, but they have limited effectiveness. Ignore the trust factor as much as possible as you establish internal controls in your office and enforce these controls on all employees, including the long-term ones.

Poor Internal Controls = Opportunity for FRAUD



Fraud Happens in Tennessee County Government Every Day

- **Tennessee sheriff office:**
 - \$31,460 stolen by an investigator who oversaw sex offender registry and was allowed to receipt funds as well as maintain database on who paid.
- **TN county Jail Commissary operation:**
 - \$13,977 cash shortage from inmate commissary collections not being deposited into the bank. Some deposits were outstanding from up to seven months from receipt. Cash shortage was reduced to \$7,327 when jail bookkeeper “remembered” she had \$6,650 of receipted funds in her car’s trunk.

More Examples in Tennessee County Government...

- **TN county jail commissary:**
 - \$9,782 cash shortage in a jail commissary kiosk machine that went undetected by jail management and was discovered by auditors. Accounting records were so deficient that additional funds may have been unaccounted for and not detected.
- **TN County Sheriff Office:**
 - \$10,651 cash shortage, bank reconciliations contained “plug” numbers to force balance the bank statement with the general ledger. Shortage went undetected by management for several months

Even More Examples in Tennessee County Government...

- **TN Sheriff Office:**

- \$162,657 of cash shortage caused by accounting/purchasing irregularities and lack of adequate internal controls in the sheriff office. Sheriff (now former) agreed to a consent judgment to pay restitution for some of cash shortage.

- **TN Sheriff Office:**

- \$1,000 cash bond stolen from a locked (?) box. Unaccounted funds were reimbursed by county taxpayers by subsequent disbursement from county general fund.

Yes...even more examples, notice the presence of internal controls weaknesses in all our examples

- **TN Sheriff Undercover Operations:**
 - \$3,000 cash shortage in confidential drug funds. Failure of management to ensure required accounting records and procedures were followed by narcotic officers.
- **TN Sheriff Undercover Operations:**
 - \$2,277 of seized and forfeited funds unaccounted for. Cash shortage resulted from a lack of management oversight of undercover narcotic operations and failure to establish adequate internal controls over seized funds/property.

Finally...

Identified cash shortages in TN county government from
FY June 30 were:

2013 – \$775,221

2014 - \$2,162,244

2015 -\$1,154,633

Majority of thefts went undetected for considerable
length of time due to lack of or poor internal controls.

<http://www.comptroller.tn.gov/repository/CA/2014/2014Cash%20Shortages.pdf>

Sound Internal Controls are Needed for Good Financial Reporting/Management

- Lack of internal controls over financial reporting = Poor budgeting and reporting practices that can lead to:
 - Unnecessary tax increases.
 - Missed grant opportunities and/or loss of grant funds.
 - Late/failure to file penalties.
 - Bond rating downgrades.

Common Breakdowns in Internal Controls

- Lack of segregation of duties for non-compatible financial duties.
- Accounts receivable/collections loss.
- Poor payroll practices.
- Inadequate capital asset tracking.
- Substandard purchasing practices.
- Absence of vendor contract management.

The Five Components of internal controls

- Control Environment
- Risk Assessment
- Control Activities
- Information and Communication
- Monitoring
- Remember these with acronym "CRIME"

Components & Principles of internal controls

Components

Control Environment

Principles

1. Demonstrate Commitment to Integrity and Ethical Values
2. Exercise Oversight Responsibility
3. Establish Structure, Responsibility, and Authority
4. Demonstrate Commitment to Competence
5. Enforce Accountability

Risk Assessment

6. Define Objectives and Risk Tolerances
7. Identify, Analyze, and Respond to Risk
8. Assess Fraud Risk
9. Analyze and Respond to Change

Control Activities

10. Design Control Activities
11. Design Activities for the Information System
12. Implement Control Activities

Information & Communication

13. Use Quality Information
14. Communicate Internally
15. Communicate Externally

Monitoring Activities

16. Perform Monitoring Activities
17. Remediate Deficiencies

Source: GAO.

Control Environment

The foundation for an internal controls system. It provides the discipline and structure to help an entity achieve its objectives.

Source: COSO, GAO Greenbook Para. OV2.04

Control Environment Demonstrate Commitment to Integrity & Ethical Values

- Setting the “tone at the top” for ethical and competent management:
 - What do the office’s employees see as acceptable behavior from their elected/appointed official?
 - What is management’s attitude towards establishing/maintaining internal controls over office operations?
- Establish standards of conduct
 - County ethics policy.
 - Personnel policies up to date and provided to employees .

Control Environment, cont...

- If your county has not adopted the 1957 or 1981 Financial Acts, be sure your county ethics policy is up to date, copies provided to your staff and is being followed. Federal grant require these steps.
- Assignment of authority and responsibility (written job descriptions for employees)
- Clear organizational structure (org. chart), who reports to who in the office?

Last Points about the Control Environment

- It's impossible to overstate the importance of the control environment's impact on overall effective internal controls.
- If management views internal controls as "red tape" or obstacles in their way, then do not be surprised when the office staff circumvent the policies.
- Even the best policies and procedures cannot overcome the force of a bad example from top management.

Risk Assessment

Examines the risks facing the entity as it seeks to achieve its objectives. This review provides the basis for developing appropriate risk responses.

Source: COSO, GAO Greenbook Para. OV2.04

Performing a Risk Assessment

- First step...You, as management, must have an understanding of the internal controls (and control deficiencies) that are in place in your office right now.
- Review the processes in your office and note the internal controls over them
 - Example: You do a surprise cash count of the office cash drawers when you get home from this training and you discover your employees are cashing personal checks from the office's cash drawers. Do you have an enforced policy against this?
- After you gain an in-depth understanding of your office's internal controls (and weaknesses), document these for later reference.
- Document the good, bad and the ugly at this time, not what you wish it looked like.

Sample Questions for Assessing Your Current internal controls/Weaknesses

- Who has a key to your office door and when were the locks last rekeyed?
- Does your office have a written store card policy and where are the cards secured when not in use? Who reconciles the monthly invoice of the card purchases/receipts?
- Who tracks fuel usage of official vehicles and reconciles usage?
- Who reviews monthly bank reconciliations and journal entries after the bookkeeper does them to ensure accurate accounting?
- Who besides the bookkeeper opens the monthly bank statement and reviews the canceled checks and timeliness of deposits for irregularities?

More Sample Questions for Assessing Your Current internal controls/Weaknesses

- When was the last time the active employee list in the payroll software was reviewed by management to check for ghost employees and bogus payroll deductions?
- Who is assigned to monitor 3rd party vendors that pay or bill the county based on a variable factor to be sure they are in compliance with their contracts?
- When was the last time the office's financials and outstanding check lists were reviewed for unclaimed property, especially for refund checks that have been returned to the office?



These are just a few example questions for assessing your current internal controls/weaknesses.

We have compiled an office specific list that addresses all 5 components of internal controls to take home with you.

Do not leave here without a copy of your office-specific internal controls assessment questionnaire!

Once You Understand Current Internal Controls...

- Identify factors that may increase risk
 - office doors not rekeyed since last election
 - computer passwords taped onto computers
 - outstanding checks that have been outstanding for so long they had to lay down and take a rest...
 - Unauthorized staff having access to your office vault
- Determine the significance of risk and likelihood of fraud, waste, abuse and inaccurate financial reporting (think reducing risk vs. cost of control).
 - **Remember, you want effective internal controls, NOT red tape.**
- Develop specific actions to reduce the risk to an acceptable level.

Documenting Your Risk Assessment

- In a small office, the official could do this on their own.
- Larger offices should involve key management (Chief Deputy, Office Manager, Assistant Clerk/Deputy Director).
- Hold a brain-storming session, look at your internal controls in place and think...

How could someone circumvent these controls?

How could reporting errors go undetected by my management team or me?

[Sample Risk Assessment Template](#)

To Summarize So Far...

1. Gain an understanding of the 5 components of internal controls.
2. Gain an understanding of your office's actual internal controls/weaknesses and document this.
3. Complete a Risk Assessment after you have gained this understanding.
4. Update your office's internal controls as you deem appropriate.

Let's Take Another 15 Minute Break



Control Activities

The actions management establishes through policies and procedures to achieve objectives and respond to risks in the internal controls system, which includes the entity's information system.

Source: COSO, GAO Greenbook Para. OV2.04

Control Activities Include:

1. Adequate segregation of duties over financial transactions and assets.
2. Proper authorization of transactions and activities.
3. Adequate documents and records.
4. Physical control over assets and records and back up of information systems' records.
5. Independent checks on performance (active senior management oversight).

Proper Segregation of Duties

Design internal controls to separate these three categories of duties:

1. Custody of assets.
2. Authorization or approval of transaction affecting those assets.
3. Recording or reporting of related transactions.

Example

- Liz is a county clerk with only a part time deputy that works seasonally when she goes on vacation or is sick.
- Liz maintains her office's general ledger and also signs the office's checks and then posts the disbursements to the general ledger.
 - >>**Lack of proper segregation of duties**<<
- Liz has requested a full time deputy and this funding request has been denied by the county commission due to lack of office work volume.

Compensating Controls

The application of different procedures that reduces the vulnerabilities in ineffectively segregated functions, which include the risk of errors, omissions, irregularities and deficiencies in process quality.

Examples of Compensating Controls

- If your county liability insurance/bond allows it, request a separate elected official/county employee to review financial operations, in an office with a lack of segregation of duties, on an on-going basis.
- County commissions under T.C.A. § 8-22-115 can elect to employ (or contract with) an internal auditor to do this review.

Employment of an Internal Auditor

- Authorized by State Statute T.C.A § 8-22-115.
- Recommended by GFOA, GAO, and Charles Hall, CPA in his book "Local Government Fraud Prevention".
- Some TN counties already employ internal auditors (Davidson, Hamilton and Knox).
- Smaller counties could consider contracting with a CPA firm to establish compensating controls or test/improve specific internal controls activities.

Back to Liz the Clerk ...

What could be a compensating control for Liz?

Have an internal auditor or other courthouse official to periodically review the canceled checks of her office to look for unauthorized transactions.

A Note About Policies

- The GAO Green Book references “policies and procedures” when discussing control activities.
 - CTAS *recommends* that current county policies (purchasing, debt, ethics, investment, personnel, etc.) be kept up to date and enforced, but county offices **NOT adopt a written internal controls policy.**

CTAS Recommendation

- County officials document, with a written internal controls assessment (*NOT A POLICY*), their in-depth understanding of the internal controls actually functioning in their office.
- Keep this assessment updated with any corrective action that management had taken after a formal risk assessment was performed.

Information and Communications

The quality of information management and communications personnel use to support the internal controls system.



Source: COSO, GAO Greenbook Para. OV2.04

Information and Communications

- Management has reasonable assurance that the methods used to operate the office's financials are accurate and can be prepared timely.
- Plan is in place to safeguard entities financial records:
 - Disaster recovery plan
 - Record retention
 - Computer system backups
- Office/department employees understand these policies and procedures.

Examples of internal controls Deficiencies in Information and Communications

- Often when top management needs basic financial information, there is an excessive rush to assemble it since the information was not readily available or accurate.
 - *Think budget or annual audit time.*
- Management is using poor quality information or outdated information for making decisions.
- Capital asset inventories are in disarray/not up to date.
- Indirect costs for federal/state grants are not tracked/reported accurately.

Monitoring Activities

Assesses the quality of performance over time and promptly resolves the findings of audits and other reviews.

Source: COSO, GAO Green Book Para. OV2.04

Monitoring Activities cont.

- Monitors office/department operations to ensure internal controls are functioning properly.
- Management addresses any identified internal controls deficiencies noted in audits.
- Works with an audit committee to review audit findings that deal with internal controls.

Monitoring Activities cont.

- Question for county audit committees:
 - Is the noted internal controls deficiency occurring in other county offices or has it been overlooked by the independent auditors?
- **Example:** The Register of Deeds receives audit finding for allowing all employees to operate out of one cash drawer, two other courthouse offices are doing it as well, however, this internal controls weakness got missed by the auditors.
- Remember!
 - **Establishing internal controls is the job of county management, not the auditors or the county commission**

Internal Controls of Third Party Service Organizations

- Trend in recent years is to outsource financial functions that used to be done in house in the past.
- Examples include:
 - Outsourcing EMS billing/AR.
 - Court clerk fine/fee collections.
 - Jail commissary operations.
- Remember!
 - **You can delegate authority, but not responsibility with public funds.**

Service Organization Control Reports

- At minimum, request a copy of the financial and compliance audit of the contracted service organization.
- Actively monitor the organization's performance.
 - If they are not delivering effective service, does it appear they have internal controls issues (example: contracted staff is poorly trained, makes a lot of billing errors).
 - If you see problems, address it with the contractor for remediation.
- Speak to your auditors this spring about any additional internal controls reports from service organizations that they would recommend based on professional guidance.

What is the CLB Role in Internal Controls of a County Government?

- Remember that the CLB is legislative, not management of the county.
- State Constitution specifically grants management authority of constitutional offices to those office holders.
- The CLB is responsible for helping to set the “Tone at the Top”.
 - If there are identified internal controls weaknesses in county operations, the CLB should provide reasonable funding to correct these issues, or to establish a compensating control.
- The CLB should maintain an audit committee separate from county management.
- CTAS and State Comptroller’s websites have guidance for establishing/maintaining an effective audit committee.

What Do I Do Now???

- Read *The Little Book of Local Government Fraud Prevention*
- Review the Comptroller's updated *Internal Controls Manual for Counties* for more guidance.
- Gain an understanding of your internal controls and possible deficiencies and document them.
 - Use the sample internal controls assessments as a guide
- Complete a risk assessment after you gain an understanding of your office's controls.
 - Use the sample risk assessment template as a guide
- Update the documented internal controls and written internal controls assessment in your office.
- Continue to monitor the controls you have put in place to ensure compliance.
- Enjoy efficient, financially sound office operations!

A Word of Caution...

- Remember that on average (per ACFE), only about 5% of fraud is detected by independent auditors.
- Should you discover fraud is occurring in your office (or have a reasonable suspicion), it is your statutory duty (T.C.A. § 8-4-501) to report this in a timely fashion (within 5 working days) to the State Comptroller.
- <https://www.comptroller.tn.gov/la/LGSfraudReporting.asp>

Now: 10 Min Break
Next: Class Exercise



Class Exercise

1. Divide into at least three groups, each group will be designated as Peter, Paul or Mary groups.
2. Each group will read the Class Exercise Overview Narrative, as well as the audit findings and the remaining part of narrative assigned to their group.
3. Each group will then determine what specific internal controls to recommend to our fictitious county official, Dwayne Washington, to put in place in his office to prevent and/or catch the fraud and financial reporting mistakes that is currently going on for either Peter, Paul or Mary.
4. Elect a group spokesperson and share with the class what your group's recommendations for new/improved internal controls are.

Recommendations-Peter

- Segregate duties to not allow Peter to be able to make changes to pay rates and add new employees in the payroll software. Also, Dwayne needs to be reviewing the payroll check run each pay period for accuracy before he signs either the manual checks or authorizes the fund transfer for direct deposit.
- Do a payroll review/audit on a regular basis (at least annually) to verify legitimate employees and look for large exemptions for tax withholding purposes along with allowing all employees to review their payroll deductions to ensure that all deductions are authorized. Also look for multiple employee paychecks being direct deposited into the same bank account.
- Assign fuel cards to either a single vehicle or employee and reconcile fuel usage monthly from fuel card invoices. Investigate irregular usage (such as multiple fill ups in same day or large usage). Have written policy and provide copy of policy to employees.
- Reconcile store card usage and store receipts monthly. Have written policy and give employees a copy of the policy.

Recommendations- Paul

- Amend personnel policy to require criminal background checks and previous employer verification for all new hires.
- Official or supervisor needs to review computerized audit log for voided receipts monthly to ensure voided transactions are legitimate. If excessive voided receipts are present, inquire why this is happening.
- Paul should not have accounts receivable write off ability, if software does not permit lock out of ability to delete an A/R, then management should review the A/R listing monthly for adjustments/write offs.
- Invoices should not be paid until work/products have been verified as received/completed.
- Management should be attentive for complaints from disgruntled vendors that did not win contracts due to brand specification bidding and follow up on this.
- Consider placing bidding opportunities on an on-line regional bidding platform to maximize competition in addition to the local newspaper.
- Consider a policy that any vendor that is required to have a business license to provide a copy of this if awarded a contract.
- Management should verify the legitimacy of any vendor with a business address that is a P.O. Box.

Recommendations-Mary

- Official needs to face reality that his bookkeeper needs training/assistance. Request help from software vendor, CTAS
- Official needs to participate in his/her professional association (COAT, TCSA, TCHOA) to network, identify good operation in nearby county and go with bookkeeper to shadow that operation
- Official (or a designated management individual) needs to review monthly financials and reconciliations to be sure that general ledger is balanced with trustee as well as subsidiary ledgers and financials are accurate.
- Official needs to ensure Mary enforces the purchasing policy when it comes to vendor payments (requires PO, requires documentation for payment, etc.) and support her in case of resistance.
- If Official is still unable to understand the accounting to adequately establish internal controls monitoring, seek assistance (contracted internal auditor, hire a chief deputy if funding available)

Post Test & Class Evaluations

***Thank You for Your Attendance and Participation!!!
Please be Careful on Your Way Home Today!!***

