

Briefing for the ACC Audit Committee



Good Evening. Thank you for allowing us to give this short brief on our concerns about the audit function in ACC government. We are here tonight as citizen members who have served on the Overview Commission in the Auditing Focus Group. We do not represent the other members of the Commission, as this analysis was completed after a majority of Overview Commission members voted to close the formal report input in August and exclude additional input. The performance of the internal audit function remains of concern and we are very appreciative of the opportunity to provide our input to the audit committee.

HIGHLIGHTS

- Brief Introduction
- General Comments
- Government Auditing Standards
- Internal control Standards
- Case Study
- Priorities and Functions of Local Internal Audit
- Risk
- Recommendations
- Practical Steps
- Selected References

Outline

As you can see from the outline, we would like to offer some of our general impressions, some background information and several recommendations.

How many Internal Compliance Audits have been Conducted in Athens- Clarke County since 2014?

What should the citizens expect to see?

—

I would like to start with the concept of 'citizen expectation' of compliance auditing. This slide begs the question of how much and how often are departments and agencies inspected for compliance. As you know, from the Office Of Operational Analysis, the answer is not often. The exception is the finance office which, as required by State law, is reviewed annually. This is conducted by a contracted outside auditor, and not managed by the OOA. Many other departments and agencies presumably complete some level of external evaluation for compliance within their fields or from other levels of government. This is neither managed or evaluated by the OOA.

HOW MANY PERFORMANCE AUDITS HAVE BEEN COMPLETED IN ACC SINCE 2014?

Is this a problem?

The answer to the question of completed performance audits is similar. There is little evidence that programmatic performance auditing is being completed at a rate that, from first view, would be considered sufficient for the size and complexity of our local government.

There are many reasons for this level of output, some are serious, but most are solvable. But the result is we cannot benefit from a comprehensive audit environment without the expectation that departments and agencies are subject to regular, and programmatic compliance and/or performance audits.

How does the Audit Committee Design and Implement the Internal Audit Strategy?

Governance of internal audit is complex and potentially political

ACC satisfies GFOA recommendation to establish a formal internal audit function through its Charter and follows best practices by governing the work through an appointed audit committee.

However, the internal audit program does not exhibit the expected characteristics of an effective system.

An effective internal audit program should be integral to management's internal control system. It should directly address standard and unique risk, and it should be programmatic. Meaning we should expect to see a standard internal audit program which gives public assurance of required controls, transparency in evaluations and which creates disciplined and compliant agencies and departments.

What is the underlying Culture in ACC regarding the Internal Audit program and standard internal control systems?

Reactive or Proactive? Standard Risk or Unique risk?

Agencies, departments and functions which are not subject to regular audit develop processes and procedures which may create more risk, may deviate from policy, and, at worst, may create opportunity for fraudulent behavior.

We don't see evidence of a formal internal control system (a managed set of internal controls for each department), and we see reluctance to implement a comprehensive internal auditing program in ACC.

Most completed audits appear to be reactive or special request. Exception is the annual financial audit which is an external audit contracted by the finance office and conducted annually by an outside auditor.



Addresses Standard and Unique Risk



Is Programmatic and Consistent



Supports Management's Internal Control Systems

Characteristics of an Effective Internal Audit System

ARE WE MEETING THESE
STANDARDS?

So I would like to review the three critical characteristics of an effective Internal Audit System.

First the program must address those critical areas of standard risk. Typically these are areas managing resources, personnel, and money. Unique risks are those that are specific to our jurisdiction or the impact of changing technology. For example, many local government's have faced threats of ransomware and cyber activism that have not only created havoc in operations, but have cost governments in the millions of dollars. Preparing and responding to this type of specific risk requires a proactive approach to risk management.

Second, creating a programmatic system is necessary if you want the benefits of creating an environment which results in high management standards. Being subject to regular, independent evaluation creates an environment of accountability and transparency.

But the key to a great internal audit program is the third characteristic, supporting comprehensive internal control system. The best programs work hand in glove with management to create, monitor, improve, and evaluate internal control systems.

WHAT IS THE INTERNAL AUDIT STANDARD ?

Industry

Federal

State

Governance

—

Private Industry has a wide array of internal audit programs. They share with Government the requirements for accounting standards and financial audits. For private industry internal audit focuses on financial audit and management accounting measures. For industry, these requirements are necessary for tax purposes and to provide transparency and accountability to shareholders. In government, internal audit satisfies similar function. Financial accountability and program effectiveness assurance to the taxpayer/citizens.

Governance: Internal Auditor Officer can work directly for elected Officials, can be incorporated into management structure, or can be appointed by outside agencies. The internal audit function can even be executed by contracted audit companies. Whatever the hierarchical structure, internal auditors must be able to maintain their independence from influence, in order to produce an effective program.



U.S. Government Accountability Office

The Yellow Book

The Generally Accepted Government Auditing Standards, also known as the Yellow Book, provides a framework for conducting high-quality audits with competence, integrity, objectivity, and independence.



High quality Government auditing programs derive from the federal standard.

The Generally Accepted Government Auditing Standards, also known as the **The Yellow Book**.

The goal of the Yellow Book, is to provide a framework for conducting high-quality audits with competence, integrity, objectivity, and independence.

Standards for Internal Control in the Federal Government

GAO-14-704G: Published: Sep 10, 2014. Publicly Released: Sep 10, 2014.

What is the Green Book?

Important facts and concepts related to the Green Book and internal control

RELATED TO GAO-14-704G

What is internal control?

Internal control is a process that helps an entity achieve its objectives. It is the first line of defense in safeguarding public resources.



Standards for Internal Control in the Federal Government, known as the Green Book, is the document that sets internal control standards for federal entities.

How does internal control work?

Internal control helps an entity



Who would use the Green Book?

Here are some of the people who use it

- Someone who manages programs for federal, state, or local government
- Someone conducting a performance audit or a financial audit
- Someone responsible for making sure that personnel follow policies and procedures related to any and all job responsibilities

How is internal control organized?

Standards for Internal Control in the Federal Government (the Green Book) is organized by the five components of internal control, and apply to staff at all organizational levels and to an entity's operations, reporting, and compliance objectives.



What makes up the 5 components?



Principles

Each of the five components contains several principles. Principles are the requirements of each component.

Attributes

Each principle has important characteristics, called attributes, which explain principles in greater detail.

LOOKING FOR MORE INFORMATION? Visit GAO.GOV/GREENBOOK. Read the full report: GAO-14-704G.

Internal control programs are also extracted from the federal level.

The Internal Control Standard is called the Green Book. The info graphic outlines the federal approach to government internal control programs.

Both programs are very detailed and complex.



Statewide Guidance

SAO's framework provides general guidance, but does not prescribe specifically how management should design, implement, and operate their internal control system.

<https://sao.georgia.gov/document/publication/riskassessment8-1pdf/download>

The state of Georgia also provides detailed guidance on internal control programs. The state issues internal control guidance which is derived from the Green Book.

Local programs and requirements are normally derived from state guidance, however it does not prescribe how local management should operate their internal control programs.

With the exception of financial audit requirements and federal programs above a certain threshold, there is a wide variance in local government's approach to internal control programs and internal audit programs.

The Five Components and 17 Principles of Internal Control

Control Environment

1. The oversight body and management should demonstrate a commitment to integrity and ethical values.
2. The oversight body should oversee the entity's internal control system.
3. Management should establish an organizational structure, assign responsibility, and delegate authority to achieve the entity's objectives.
4. Management should demonstrate a commitment to recruit, develop, and retain competent individuals.
5. Management should evaluate performance and hold individuals accountable for their internal control responsibilities.

Risk Assessment

6. Management should define objectives clearly to enable the identification of risks and define risk tolerances.
7. Management should identify, analyze, and respond to risks related to achieving the defined objectives.
8. Management should consider the potential for fraud when identifying, analyzing, and responding to risks.
9. Management should identify, analyze, and respond to significant changes that could impact the internal control system.

Control Activities

10. Management should design control activities to achieve objectives and respond to risks.
11. Management should design the entity's information system and related control activities to achieve objectives and respond to risks.
12. Management should implement control activities through policies.

Information and Communication

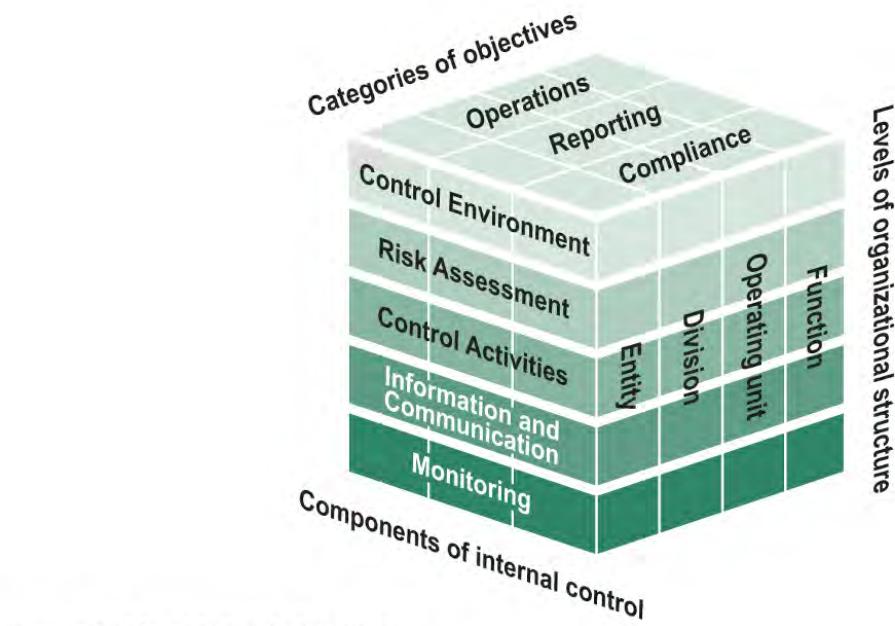
13. Management should use quality information to achieve the entity's objectives.
14. Management should internally communicate the necessary quality information to achieve the entity's objectives.
15. Management should externally communicate the necessary quality information to achieve the entity's objectives.

Monitoring

16. Management should establish and operate monitoring activities to monitor the internal control system and evaluate the results.
17. Management should remediate identified internal control deficiencies on a timely basis.

Source: GAO, I GAO-14-704G

I am not going to read this page but wanted to include this information from the state guidance on the Components and Principles of Internal Control.



Sources: COSO and GAO. | GAO-14-704G

As you can see, the State of Georgia pulls its guidance directly from the Federal Green book . You might recognize this graphic interpretation from a previous slide.

Recommended Regular Actions by Audit Committees of Small Local Governments

- Review the prior month's bank reconciliation detail.
- **Ensure that the organization's internal control policies are effective and, more importantly, being followed.**
- Meet with representatives of the bank to review signature cards to ensure that all signers are authorized and that there are no unauthorized accounts.
- Meet with the insurance agent to ascertain that coverage is adequate for all policies, with particular attention to fidelity bonds.
- Test the payroll by comparing payroll records to personnel files.
- Contact each employee directly to ensure that there are no "ghosts on the payroll."
- Interview all employees who are responsible for receiving and disbursing checks to ensure that policies and controls are adequate and being followed.
- Test disbursements to ensure that invoices have been approved for payment properly.
- Check the accounts payable files and physically contact new vendors to ensure that they exist.

Finally I wanted to touch on the governance of the internal audit function in local government. Many small governments find it cost prohibitive to have an internal audit office. We are lucky to have it as well as to have an audit committee. This is the recommended structure in best practices. But implementation of an internal audit program is hard and sometimes even harder in small governments.

I wanted to include this page of advise that has some relevant recommendations for the actions of audit committees. This set of advice is more directed to audit committees that function as the internal audit body, however some of the advice is applicable.

The internal audit committee should report its findings to the governing body and external auditors. Developing an internal audit committee may be a government's best and, in many cases, only way to determine that internal controls are functioning properly.

-

Are we large enough, complex enough?

Don't we have enough oversight?

Award winning Financial Audits!

We have appropriate checks and balances!

Do We need an Internal Auditor Office in Athens?



ISSUER COMMENT
22 September 2017

RATING
General Obligation (or GO Related)¹
Aa1 / No Outlook

Athens-Clarke County U
GA

Annual Comment on Athens-Clarke

This question has been asked in the past, and continues to be a valid question considering the level of audit output in the last few years. In our view it is a cost/benefit analysis. Is the risk of not having an office at all or even maintaining an office restrained from completing a comprehensive program - worth the savings of not having an established office?

Indeed, with a couple of exceptions we seem to be doing fine. I included a screenshot of our Moody's credit analysis which shows us a Aa1- nearly the highest rating a local government can achieve. These ratings include specifically an analysis of financial risk, particularly with regards to debt and financial position. They view ACC as low risk for serious financial issues. Every year our financial statements are awarded the highest level of recognition for completeness and accuracy. Is this because we are doing everything right? Have we implemented all the appropriate checks and balances? Does this mean we have mastered our risk?



CASE

COUNTY CORRUPTION

Buncombe County
Manager Convicted. Asst Manager convicted.
Commissioner plead guilty. 2 employees in jail.

Ashville Airport Authority
Received Funds

Ashville/Buncombe Economic Development
Issued Incentive Funds

I would like to address those questions with a relatively recent case from a County in North Carolina.

The picture at the bottom is Joe Wiseman, a contractor convicted in federal court last year for bribing Buncombe county officials in exchange for contracts. He is serving 37 months in prison and owes the county over \$900,000 in civil suit charges.

The top picture is the former longtime County Manager Wanda Green, after she was ordered to pay \$750K and to report to federal prison. Her replacement, Mandy Stone, was also indicted and ordered to pay \$171,000. Two other senior county officials are also serving federal sentences.

Finally, the center picture, is former County Commissioner Ellen Frost, caught up in the scandal, with a well-meaning, but still self serving, business support deal that violated regulations.

How could this happen in such a good county with excellent financial reports and a solid credit rating?

The answer, provided by the auditor of the City of Asheville, which is an incorporated jurisdiction of Buncombe County, the power structure managed the system to allow for fraud to continue.

"the internal auditor was not allowed to implement internal controls"

In this case it was not in management's interests to have a protective internal control system.

**Primary – Compliance
(reactive)**

**Secondary – Internal control
programs and
Performance
Analysis
(proactive)**

**Tertiary – Special Analysis
(reactive)**

Functions of an Internal Audit Office

IG/GAO/SAO/LIA

After looking at that sobering case, I would like to review the important roles of the internal auditor. Each critical to achieving high expectations of managing our public functions and our tax dollars.



Most Audit Concerns revolve around financial compliance.

For any of you who have read the annual financial statements every year know there is some truth to this cartoon!

Most financial documents are very detailed and very technical. It sometimes requires an accountant/CPA to explain them. But we do a good job every year on our financial statements, and we satisfy all required statutory requirements and audit analysis.

—

Compliance versus Program Analysis



"Remember, 'accounting' and 'accountability': nothing in common."

As I mentioned in a previous slide, the primary job of internal auditing is the compliance function.

But there is much more to accountability beyond mere financial or procedural accounting. Accountability in Program management is a fair expectation from the taxpayer. There is a true requirement to ensure that programs are not just efficient, but that they are accountable and effective.



Primary Function

Compliance Evaluation (reactive)

1. Financial Compliance – Annual Financial Audits by State Law
2. Procedural Compliance – Following federal, state and local laws for managing and preventing Waste, Fraud, and Abuse
3. Policy Compliance – Following specific local guidance

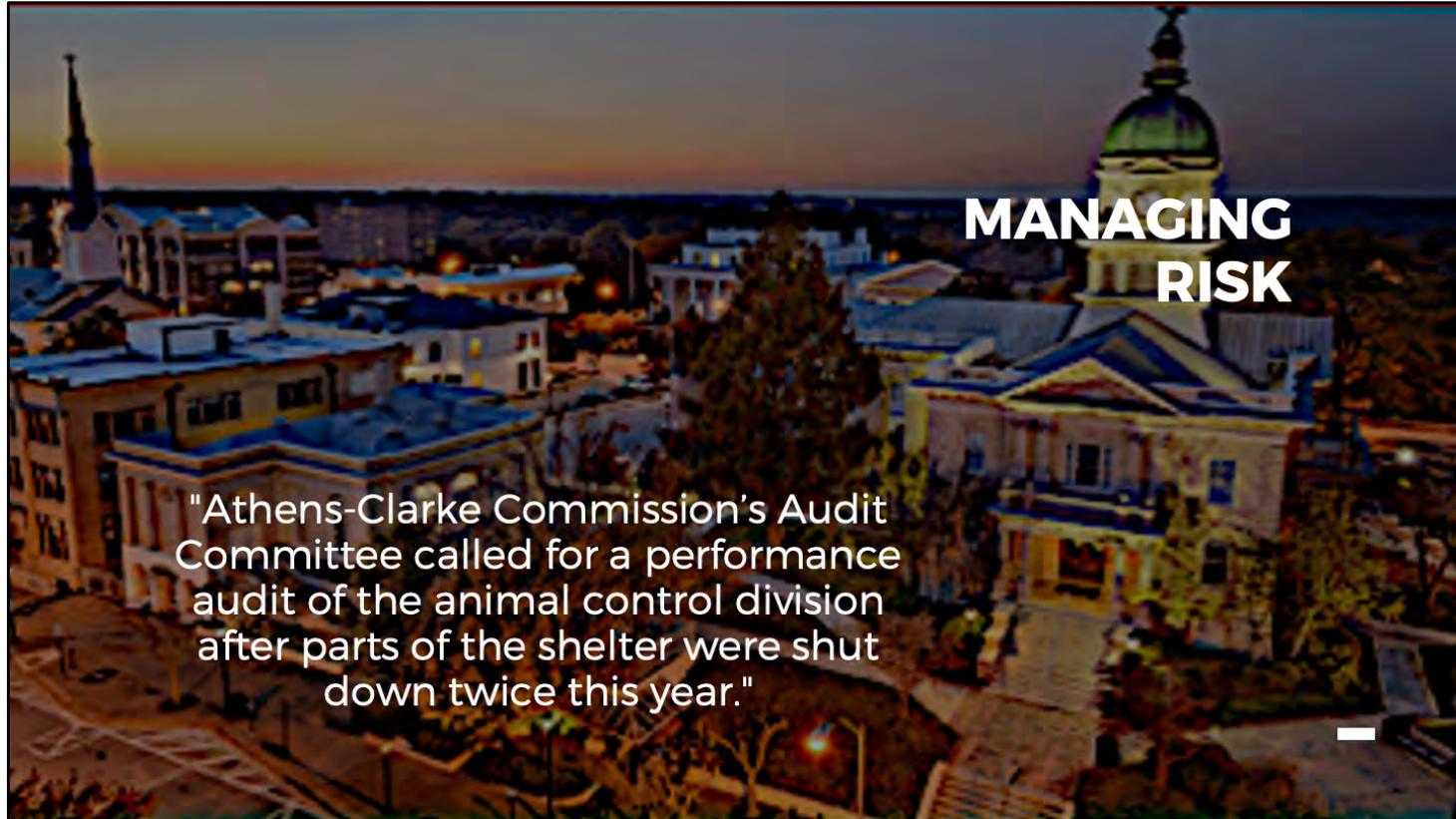
Tertiary Function

Performance Evaluation and Improvement (proactive)

1. Efficiency and Effectiveness. – Program improvement
2. Special Analysis – By specific request

Secondary Function

1. Evaluating and Supporting Internal Control Systems (proactive)
2. Assisting Management in developing and evaluating Internal Control Measures Specific risk management measures in each identified area of resource management imbedded in a government wide internal control program. POC for Whistleblower Program



Unique vulnerabilities and Threats.

Cybersecurity Ransomware Hacktivism

An ACFE study noted that 50 percent of uncovered fraud schemes in the government sector were initially detected through employee tips. Governments should encourage such tips by developing a formal whistleblower policy.

The ACFE study also noted that 18 percent of uncovered fraud schemes were detected as a result of internal audit procedures. An internal audit committee may be a government's best and, in many cases, only way to determine that internal controls are functioning properly.

The Association of Certified Fraud Examiners studies fraud prevention and fraud detection.

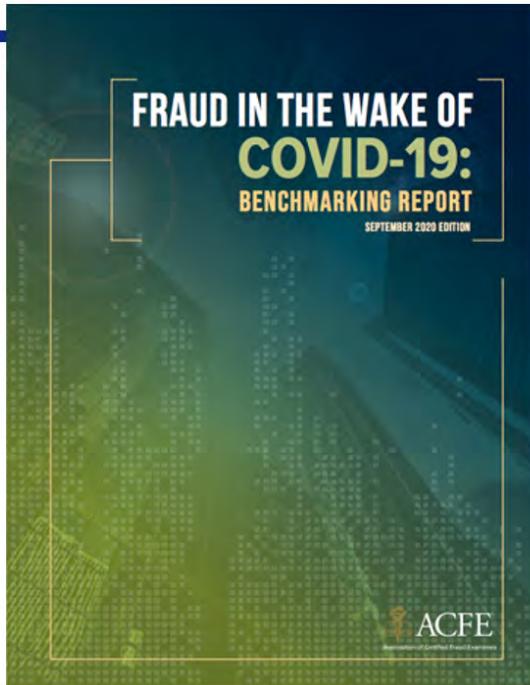
Important takeaways are that governments should encourage employee tips by establishing a

- Formal Whistleblower program (50% uncovered schemes)

Internal audit procedures are effective in detecting fraud.

- Internal Audit (Internal Controls) (18% uncovered Fraud.)

But also remember that preventing fraud by supporting strong programs is the best approach.

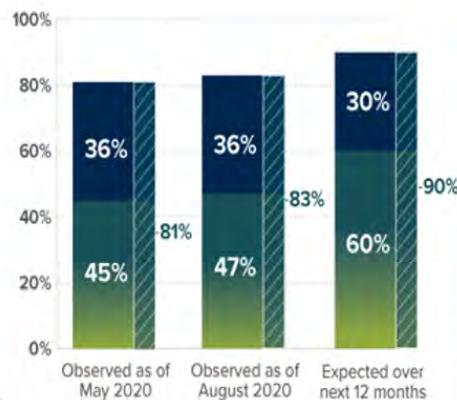


In our current environment, how much thought has been given to the very real potential risks from all the emerging programs from the pandemic?

These are astonishing numbers, and should stimulate prevention tactics in our own government.

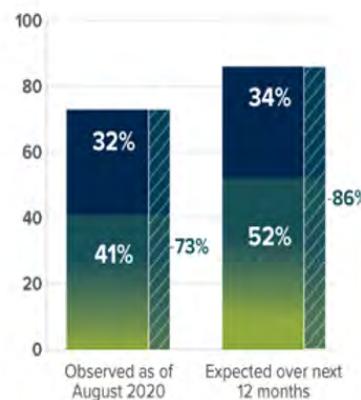
CHANGE IN SPECIFIC FRAUD RISKS

Cyberfraud

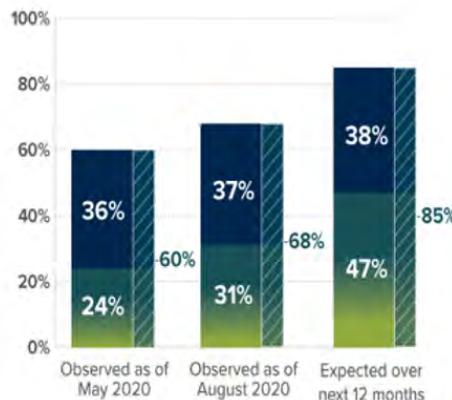


Unemployment fraud

Unemployment fraud was not included in the May 2020 benchmarking study.



Payment fraud



■ Significant increase ■ Slight increase

This slide is offered just to identify specific risks identified under COVID

RECOMMENDATIONS

- CONSIDER CHANGING THE STRUCTURE OF THE AUDIT COMMITTEE TO IMPROVE TECHNICAL CAPABILITY

Establish a baseline for effective governance of this important accountability function.



- SET A PERFORMANCE STANDARD FOR OFFICE OF OPERATIONAL ANALYSIS (OOA)

Support, Protect, and Resource it to achieve this standard.

- INCENTIVIZE COOPERATION BETWEEN MANAGEMENT AND THE INTERNAL AUDIT FUNCTION

Reward attaining Qualification in local government fraud analysis and internal control programs.

Practical Steps

SET AN ENVIRONMENT OF ONGOING INTERNAL AUDIT -
FOR EXAMPLE: 20% OF DEPARTMENTS/PROGRAMS
PER YEAR

AUTOMATION OF INTERNAL CONTROL PROGRAM

AUTOMATION OF INTERNAL AUDIT PROGRAM

HIRE EXTERNAL ASSISTANCE TO CATCH UP ON
"OVERDUE AUDITS" OR DEVELOP DEPARTMENT LEVEL
AUDIT SYSTEM



Briefing for the ACC Audit Committee

THANK YOU



REFERENCES



<https://www.gao.gov/yellowbook/overview>

Standards for Internal Control in the Federal Government

GAO-14-704G: Published: Sep 10, 2014. Publicly Released: Sep 10, 2014.

GOV-Fraud-Considerations-and-Case-Studies-P.-Mantone-QC-Approved

<https://www.osc.state.ny.us/files/local-government/publications/pdf/preventingfraud.pdf>

<https://www.ca-ilg.org/ethics-transparency>

<https://www.rubinbrown.com/article/955/Focus-On-Public-Sector-Detecting-And-Deterring-Fraud-In-Local-Governments.aspx?articlegroup=1117>

<http://doas.ga.gov/assets/State%20Purchasing/Presentations%20for%20The%20Sessions/Internal%20Controls%20and%20You%20final.pdf>

<https://sao.georgia.gov/policies-and-procedures/internal-controls#toc-internal-controls-guidance>