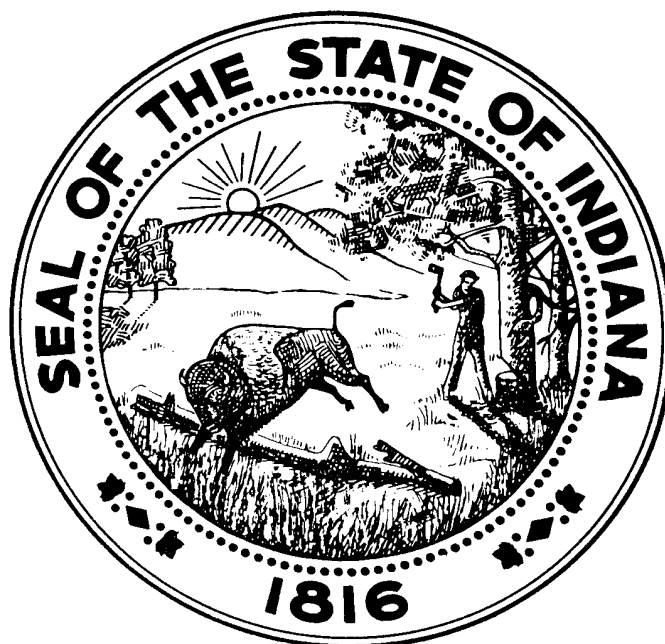


INDIANA STATE BOARD OF ACCOUNTS

AUDIT AND FINANCIAL REPORTING SUBCOMMITTEE MEETING

October 22, 2015



FILED
10/25/2017

October 22, 2015

Members of the Audit Committee:

Good afternoon Chairman Merritt and members of the audit committee. Thank you for the opportunity to review the operations of the State Board of Accounts and to discuss impending issues as we move forward.

As you are aware, “The audit and financial reporting subcommittee of the legislative council is established to assure the independence of the state board of accounts.” Ind. Code § 2-5-1.1-6.3(b).

Auditor independence is the cornerstone of the auditing profession and is the foundation of the public’s trust not only in the accounting profession but also in the citizen’s confidence in audits and investigations conducted by the State Board of Accounts. Since the creation of the State Board of Accounts in 1909, independence has always been held sacred and unimpeachable. The Board acts in a nonpartisan manner and is always mindful to remain independent in accordance with established standards. *Government Auditing Standards* issued by the Comptroller General of the United States and *Generally Accepted Auditing Standards* issued by the American Institute of Certified Public Accountants require auditor **independence in fact** as well as **independence in appearance**. And they specify what constitutes impairments to independence.

Real and perceived independence are essential to achieve the goals of true independence. Real independence refers to independence of the auditor, also known as independence of mind. More specifically, real independence concerns the state of mind an auditor is in, and how the auditor acts or deals with a specific situation. An auditor who is independent ‘in fact’ has the ability to make independent decisions even if there is a perceived lack of independence present, or if the auditor is placed in a compromising position by someone in the executive branch or the legislative branch of government. Many difficulties lie in determining whether an auditor is truly independent because it is impossible to measure a person’s mental attitude and personal integrity. An auditor’s objectivity must be beyond question; but how can this be guaranteed and measured? That is why perceived independence is so important.

It is essential that auditors not only act independently, but also appear independent. If an auditor is in fact independent, but one or more factors suggest an impairment to true independence, the public may conclude that the auditor does not present a true and fair report. Independence in appearance reduces the opportunity for an auditor to act in any manner other than independently, which lends credibility to the final audit report.

Through the establishment of this audit and financial reporting subcommittee, I believe that we fully meet the structural independence requirements established through the standards. Specifically, real independence was achieved through the specific language of Ind. Code § 2-5-5.1-6.3(c) which states, “It is the responsibility of the audit committee to provide independent review and oversight of the state board of accounts and the examination process used by the board of accounts.”

In carrying out the stated objective of ensuring the independence of the State Board of Accounts, the audit and financial reporting subcommittee shall perform the following tasks:

1. Review and monitor the independence and objectivity of the state board of accounts and the effectiveness of the examination process.

Specifically related to the effectiveness of the examination process, the Board hired an outside consultant, Bronner Group, LLC, to perform a strategic optimization assessment of the State Board of Accounts. A summary of the preliminary results is attached in the Appendix for your review. If any member of the committee has a question relating the assessment or the effectiveness of the examination process, a member of Bronner Group is glad to respond in writing or to attend the next committee meeting.

2. Evaluate the findings and recommendations of any peer review.

The peer review conducted by the National State Auditors Association (NSAA) of the State Board of Accounts began on Wednesday, October 14 and should conclude on Friday, October 23. It is anticipated that the peer review team will meet with the State Examiner on Friday, October 23 for an exit conference. The final peer review report is expected to be issued by December 1, 2015. A copy of that report will be posted on the State Board of Accounts' website and provided to each member of this committee.

3. Review reports of examinations to monitor the integrity of the financial reporting process and the effectiveness of the state board of accounts in evaluating internal accounting controls of audited entities.

The State Board of Accounts is statutorily required to file all audit reports with (1) the officer or person examined, (2) the auditing department of the municipality examined, if applicable, and (3) the legislative services agency (LSA). Ind. Code § 5-11-5-1(a). The Board also posts all of its reports of examinations on its public website. The State Board of Accounts firmly believes in the integrity and effectiveness of the financial reporting process.

With the implementation of Ind. Code § 5-11-1-27 and Ind. Code § 5-11-1-28, the State Board of Accounts is more actively involved in evaluating the internal accounting controls of audited entities. Specifically, the Board developed the *Uniform Internal Control Standards for Indiana Political Subdivisions* manual from which political subdivision are statutorily required to adopt their own internal control procedures. The Board is required to report on the existence of internal control policies of political subdivisions, as well as mandatory internal control training. In addition, three state agencies (BMV, FFSA, and DOR) are required to undergo annual internal audits and reviews of internal control systems. The State Board of Accounts is responsible for compiling the internal audits and submitting the final report to several parties, including this committee.

4. Monitor the actions of the examined entities to follow up on reported findings to assure corrective action is taken.

The State Board of Accounts supports a statutory requirement that all audited entities provide an action plan to address any uncorrected reported findings. The Board also supports the authority of this committee to enforce any such statutory requirement. Currently, there is no requirement that any corrective actions on findings reported by the State Board of Accounts be made, and there is no enforcement authority granted to this committee other than the general charge to “monitor the actions of the examined entities . . . to assure corrective action is taken.” Ind. Code § 2-5-1.1-6.3(b)(4). Several states have a detailed process in place to address corrective actions of reported findings. An example from Florida is provided in the Appendix for your review.

5. Review the policy on the engagement of the state board of accounts to supply nonaudit services.

The State Board of Accounts adopted the “Provision of Nonaudit Services to Audited Entities” as set forth in *Generally Accepted Government Auditing Standards* (the “Yellow Book”) by the Comptroller General of the United States. A copy of the standard is provided in the Appendix for your review.

6. Provide guidance to the state board of accounts on any accounting, examination, or financial reporting matter requested.

A. Status of Internal Audits of BMV, FSSA, and DOR

The State Board of Accounts is required to compile a final report of annual (1) internal audits and (2) reviews of internal control systems conducted by the BMV, FSSA, and DOR. Ind. Code § 5-11-1-28. The final report must be submitted to the governor, auditor of state, chairperson of this committee, director of the office of management and budget, and legislative council by September 1 of each year. *Id.*

Indiana Code § 5-11-1-28 went into effect on July 1, 2015 (*see* HEA 1264), so the first annual audit will be fiscal year 2016—July 1, 2015 through June 30, 2016. The State Board of Accounts met with officials from BMV, FSSA, and DOR regarding the internal audit requirements under the new law.

- i. BMV has 7 internal audit staff. BMV recently hired a central office internal audit director and plan to hire additional internal audit staff. Currently, BMV’s internal audit staff conducts audit procedures on each license branch and outside vendors who have access to BMV systems. The additional new staff will focus on central office audit procedures.
- ii. FSSA has 16 internal audit staff. FSSA’s internal auditors are responsible for fiscal auditing of internal FSSA programs and agencies, as well as fiscal monitoring of FSSA providers and contractors. The purpose of current internal audits is to promote efficiency and ensure compliance with grant and contract requirements.

iii. DOR has 2 internal audit staff. DOR's internal audit staff is working on the development of a key control program to allow DOR to identify areas that need audit attention and improved efficiencies. In addition to this program, there are several other special projects that DOR's internal audit staff works on throughout the year.

All three agencies are aware of the new statute and are working with their internal audit staff on the fiscal year 2016 internal audit. At this time, the State Board of Accounts anticipates that all three agencies will timely perform the required internal audit and review of internal control systems.

B. Fraud Division

The State Board of Accounts recently hired a Director of Special Investigations to lead our Fraud Division. The Fraud Division's primary function is to perform investigative examinations, which typically stem from items discovered during a regular audit or tips from law enforcement, public officials, employees, or concerned citizens.

Our Director of Special Investigations, Andy Shank, leads approximately 20 highly-experienced field examiners from around the state. Andy brings a wealth of law enforcement experience with him. He was in the Organized Crime and Corruption Unit with the Indiana State Police, and was assigned to the FBI Complex Financial Crimes and Public Corruption Task Forces. Andy has 14 years of law enforcement experience and still maintains a Top Secret federal security clearance. As a result of Andy's leadership, we are experiencing strengthened relationships with local law enforcement agencies, Indiana State Police, FBI, and state and federal prosecutors. Our goal is to avoid the duplication of investigative efforts of law enforcement and to aid state and federal prosecutors with complete investigative packages that do not require significant additional time and resources.

Andy still faces several challenges, including the necessity of involving outside law enforcement officials in every case because, despite Andy's law enforcement credentials, he cannot independently present a complete investigative case to prosecutors for consideration of criminal charges. Without law enforcement powers, Andy is also limited in his ability to testify and take confessions while preserving the admissibility of information. Moreover, Andy is prohibited from accessing databases of financial information, such as Suspicious Activity Reports (SARs) and Currency Transaction Reports (CTRs) required to be filed by financial institutions. These sources of financial information are tremendously valuable in any financial fraud audit, but especially important in cases that are ripe for consideration by state or federal prosecutors.

In the past year, the Fraud Division reported over \$4 million in misappropriated public funds and filed 10 reports with public misappropriation in excess of \$50,000. Those 10 reports alone account for over \$3.6 million in loss of public funds. *See* Appendix A for additional information. We currently have over 20 ongoing investigations in the Fraud Division, and anticipate at least 5 of them to exceed \$50,000 in misappropriated public funds.

7. Legislative Recommendations and/or Corrections

The State Board of Accounts recommends the following corrections to laws enacted in 2015:

1. Remove the phrase “county of residence” from IC 5-4-1-5.1(b).
2. Provide a waiver procedure for the 45-day waiting period for the issuance of audit reports required in IC 5-11-5-1(b)(6).
3. Clarify that SBOA workpapers received by law enforcement officers, the attorney general, a prosecuting attorney, or a legal representative of the state or the United States pursuant to IC 5-11-5-1(i) are no longer confidential if used in an action with respect to the misappropriation or diversion of public funds.
4. Strike the phrases “internal control procedures” and “and procedures” from IC 5-11-1-27(e), (g)(1), (g)(2), (h)(1), and (i)(1).
5. Remove the word “annual” from the audit requirements of (1) regional venture capital funds in IC 6-3.6-10-7(d), (2) local venture capital funds in IC 6-3.6-10-8(c), and (3) the CIB bid fund in IC 5-13-10.5-18(g).

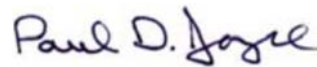
The State Board of Accounts asks the audit committee to take the following under consideration:

1. Fraud Division:
 - a. Create a statutory position, Director of Special Investigations, to lead the Fraud Division, and require the individual to have at least 10 years of previous law enforcement experience and police academy training.
 - b. Provide the Director of Special Investigations limited law enforcement authority to better assist police and prosecutors, and avoid the duplication of investigative efforts.
2. Non-profits and other entities:
 - a. Update the language in Ind. Code § 5-11-1-9(b) and (c) regarding which entities must be audited, the dollar and percentage thresholds for audit, and the purpose and effect of waiver.
 - b. Clarify the scope of audits for economic development entities.
 - c. Define the phrase “public funds.”
3. Surety Bonds:
 - a. Require surety bonds for charter school organizers and/or fiscal officers and employees handling public funds.

- b. Set minimum bond amounts for school treasurers and extra-curricular treasurers and employees handling public funds.
 - c. Require school bonds to be payable to the state like all political subdivision bonds.
4. Failure of an audited entity to take corrective action:
- a. Require an audited entity to file a corrective action plan for any item that was reported in a previous audit, but not addressed or corrected. File the corrective action plan as a response to the current audit.
 - b. Require the SBOA to follow-up on all corrective action plans and provide an enforcement mechanism to the audit committee when a corrective action plan is not provided or implemented. The enforcement mechanism may be progressive, such as letter of inquiry, then personal appearance before the audit committee, and finally the withholding of revenue or budget approval.

Thank you for your time, your thoughtful review of the operations of the State Board of Accounts, and your continued support.

Sincerely,



Paul D. Joyce, CPA
State Examiner

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ITEMS PRESENTED FOR APPROVAL

1. Risk-based audit criteria

Ind. Code § 5-11-1-25(b) states, in part:

[T]he state board of accounts shall conduct examinations of audited entities at the times determined by the state board of accounts, but not less than once every four (4) years, using risk based examination criteria that are established by the state board of accounts and approved by the audit committee. The risk based examination criteria must include the following risk factors:

- (1) An audited entity has a newly elected or appointed fiscal officer.
- (2) An audited entity:
 - (A) has not timely filed; or
 - (B) has filed a materially incorrect or incomplete; annual financial report required by section 4 of this chapter.
- (3) Any other factor determined by the state examiner and approved by the audit committee.

The State Board of Accounts has established the following 11 risk-based audit factors:

1. The audited entity has a newly elected or appointed fiscal officer.
2. The audited entity has not timely filed or has filed a materially incorrect or incomplete annual financial report (AFR).
3. The SBOA receives a credible report of alleged impropriety.
4. The SBOA receives a report of erroneous or irregular variances, losses, shortages, or thefts of public funds or property.
5. The audited entity had discussion items or comments in its last audit that have not been addressed or corrected.
6. The audited entity does not have sufficient cash collection, deposit, and reconciliation procedures. These procedures may include:
 - a. timely issuing receipts for all monies received,
 - b. classification of receipts received each day match deposit (e.g., cash versus checks),
 - c. bank deposits are completed daily,
 - d. bank account balances are reconciled to ledger balances monthly, and
 - e. reconcilements are reviewed and/or approved by another.

7. The audited entity is not following proper disbursement procedures. These procedures may include:
 - a. proper forms are used for disbursements,
 - b. disbursements are itemized,
 - c. proper signatures and/or approval of all disbursements,
 - d. disbursements contain supporting documentation,
 - e. certifications of correctness are completed, and
 - f. disbursements do not exceed appropriations.

8. The audited entity is not utilizing proper payroll procedures. These procedures may include:
 - a. establishing salary ordinances,
 - b. maintaining separate accounts for payroll,
 - c. using paper checks versus direct deposit,
 - d. timely issuing W-2s, and
 - e. properly withholding taxes and/or deductions and promptly remitting those payments.

9. The audited entity has irregular or disconcerting account activity. This activity may include:
 - a. electronic fund transfers;
 - b. credit card purchases or payments;
 - c. newly opened accounts; and
 - d. penalties, interest, and finance charges for late payments.

10. The audited entity performs or allows high risk activities. The activities are specific to the entity, but may include:
 - a. school extracurricular ticket sales,
 - b. large cash volumes,
 - c. vending machines or other easily accessible cash streams,
 - d. township assistance payments, and
 - e. payments and/or salary to family members.

11. Any other factor the State Examiner deems appropriate.

2. Materiality

Indiana Code § 5-11-1-27 states, in relevant part:

(b) As used in this section, "material" means a significant or consequential amount, as determined by the state examiner and approved by the audit committee.

(j) All erroneous or irregular material variances, losses, shortages, or thefts of political subdivision funds or property shall be reported immediately to the state board of accounts. For all material variances, losses, shortages, or thefts, the state board of accounts shall:

(1) determine the amount of funds involved and report the amount to the appropriate government and law enforcement officials;

(2) determine the internal control weakness that contributed to or caused the condition; and

(3) make written recommendations to the appropriate legislative body or appropriate official overseeing the internal control system addressing:

(A) the method of correcting the condition; and

(B) the necessary internal control policies and internal control procedures that must be modified to prevent a recurrence of the condition.

A. Materiality threshold for political subdivisions.

In general, each political subdivision must develop their own policy on materiality because the causes of irregular variances, losses, shortages, and thefts are as broad and varied as the political subdivisions in which the incidents occur. For example, a \$500 variance in Fort Wayne is not necessarily as concerning as a \$500 variance in Pershing Township, Jackson County. On the other hand, a \$100 variance in Fort Wayne that occurs every Friday may be material.

Political subdivisions must recognize that variances, losses, shortages, and thefts may occur. If an incident occurs, the political subdivision should have a policy in place that outlines the steps to be taken. The policy should include a materiality threshold at which point the political subdivision reports incidents to the State Board of Accounts.

Each political subdivision is the best determiner of the qualitative and quantitative factors unique to the unit in arriving at materiality.

The policy should be detailed, and materiality thresholds should distinguish between incidents involving cash and other types of assets. The policy should also address maintenance of documentation and resolution of incidents that do not meet the materiality threshold.

The policy should also consider IC 5-11-1-27(1), which requires public officials who have actual knowledge of or reasonable cause to believe that there has been a misappropriation of public funds to immediately send written notice of the misappropriation to the State Board of Accounts and the prosecuting attorney.

If a political subdivision does not develop a policy on materiality, then the threshold is \$0.00 and the political subdivision must report *all* irregular variances, losses, shortages, and thefts to the State Board of Accounts.

B. Materiality threshold for the State Board of Accounts.

For incidents determined material by a political subdivision and reported to State Board of Accounts, the SBOA will use a qualitative and quantitative analysis to determine materiality for investigative and reporting purposes, as well as written internal control recommendations.

The State Board of Accounts has developed the following procedures for receiving and reviewing reports of material irregular variances, losses, shortages, and thefts:

1. On the SBOA website there is a notification link, which allows public officials to report via e-mail any material irregular variances, losses, shortages, or thefts. Telephone and in-person reporting is also acceptable.
2. Reports of irregular variances, losses, shortages, or thefts are maintained by the SBOA on an electronic log sheet.
3. Reports will be followed up with a return e-mail or call to gather additional information as necessary.
4. Reports and any additional information collected will be analyzed weekly by the SBOA to determine further action as follows:
 - a. If it is determined that the irregular variance, loss, shortage, or theft is immaterial, the information will be placed in the political subdivision's data file and marked as "For Informational Purposes Only."
 - b. If it is determined that the irregular variance, loss, shortage, or theft is material, the political subdivision will be scheduled for an on-site review.
5. The SBOA will update the electronic log sheet as the reporting process continues, and will include any field staff comments as well as the final resolution of the report.

3. Internal control standards

Indiana Code § 5-11-1-27(e) states:

In the compliance guidelines authorized under section 24 of this chapter, the state board of accounts shall define and the audit committee shall approve not later than November 1, 2015, the acceptable minimum level of internal control standards and internal control procedures for internal control systems of political subdivisions, including the following:

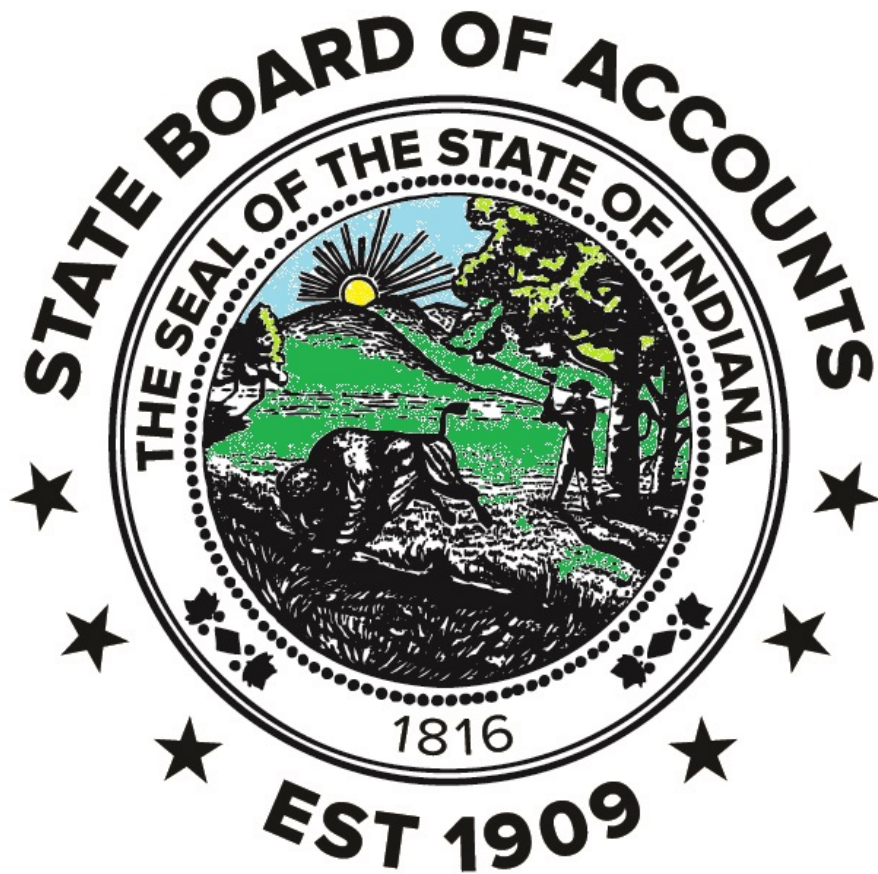
- (1) Control environment.
- (2) Risk assessment.
- (3) Control activities.
- (4) Information and communication.
- (5) Monitoring.

The internal control standards and procedures shall be developed to promote government accountability and transparency.

The State Board of Accounts developed the attached *Uniform Internal Control Standards for Indiana Political Subdivisions* manual, which contains the acceptable minimum level of internal control standards. The standards will be available to all audited entities online at www.in.gov/sboa, or, if requested, distributed in paper form.

The political subdivisions must use the internal control standards set forth in the manual to develop their own internal control procedures. *Generally Accepted Government Auditing Standards* (the “Yellow Book”) by the Comptroller General of the United States prohibits the State Board of Accounts from providing political subdivisions the internal control procedures which are subject to audit by the SBOA.

UNIFORM INTERNAL CONTROL STANDARDS FOR INDIANA POLITICAL SUBDIVISIONS



Paul D. Joyce, CPA
State Examiner

September 2015



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A MESSAGE FROM THE STATE EXAMINER, PAUL D. JOYCE

My Fellow Public Servants:

Indiana Code 5-11-1-27 requires each political subdivision to maintain a system of internal control to promote government accountability and transparency. As a result, the State Board of Accounts has developed the *Uniform Internal Control Standards for Indiana Political Subdivisions*, which provides a basis of common understanding to assist public sector managers in this effort. This manual defines what an internal control system is and against what standards your system is measured when evaluated for sufficient controls. Our goal is to work with you in partnership to achieve a system of controls that will be instrumental in ensuring that all public officials and employees serve the people with responsibility, integrity, loyalty, and efficiency.

Paul D. Joyce
Paul D. Joyce, CPA
State Examiner

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Introduction

Indiana Code 5-11-1-27 provides that internal control standards shall be defined to promote government accountability and transparency. This statute applies to all political subdivisions under IC 5-11-10.5-1, including counties, townships, cities, towns, school corporations, library districts, fire protection districts, public transportation corporations, local hospital authorities or corporations, local airport authority districts, special service districts, special taxing districts, or other separate local governmental entities that may sue and be sued.

The State Board of Accounts (SBOA) is required under Indiana Code 5-11-1-27(e) to define the acceptable minimum level of internal control standards. To provide clarifying guidance, the State Examiner compiled the standards contained in this publication: *Uniform Internal Control Standards for Indiana Political Subdivisions*. These standards have been based on those advocated by leading authorities in the field of internal control. All political subdivisions subject to audit by SBOA are expected to adhere to these standards, and will be evaluated accordingly in any audits that are performed by or on behalf of the SBOA.

Internal control is a process executed by officials and employees that is designed to provide reasonable assurance that the mission and objectives of the organization will be achieved. The internal control process includes any policy, system, or action that corresponds directly to the objectives of the organization and adjusts to change when necessary.

In government, missions and objectives change and evolve as a result of various factors such as new management, change in staff, rapid growth, technological advances, and new programs or services. As missions and objectives change, internal controls must be monitored and evaluated for applicability in the new context and adjusted accordingly. Often, new internal controls are implemented without a corresponding deletion in obsolete controls. Maintaining processes which have no clear purpose fosters confusion and ineffective utilization of resources, resulting in a control weakness. Therefore, internal controls should be identified, monitored, and evaluated on a continual basis.

Ultimately it is the people at every level of the organization that are instrumental in ensuring the success of the internal control process. Accordingly, internal controls integrate the attitudes and actions of people within the organization into the processes.

There are many benefits of a well-defined, relevant internal control process. The process produces accountability and transparency that is evident both internally and externally. Internally, the accomplishment of objectives may be quickly evaluated; any inefficiency may be addressed and corrected immediately. Internal control procedures encourage efficient uses of

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government time and resources through the establishment of baselines and other measurable goals. Measurable goals and objectives allow the government to externally communicate success in the performance of missions and objectives. Moreover, the government may convey to the public its commitment to detect and eliminate fraud, waste, and abuse. Internal control procedures reduce costs by enabling timely completion of responsibilities as well as prevention of waste, abuse, or fraud. Additionally, audit costs are reduced as documented processes exist to reasonably ensure that operational, reporting, and compliance objectives are achieved. Finally, the inherent savings and goodwill fostered with the citizens through proper stewardship of their assets is immeasurable.

The internal control process is based on well-established and widely-recognized fundamental principles that operate as an integrated whole but are best understood when analyzed individually. The five components that are recognized as basic to any internal control system are listed in IC 5-11-1-27(d), as follows: Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring. Additionally, the Committee of Sponsoring Organizations of the Treadway Commission COSO provides a framework that includes principle characteristics of these five components and three categories of generalized objectives. The U.S. Government Accountability Office has adapted these components and principles for the Federal government through its *Standards for Internal Control in the Federal Government*, otherwise known as the "Green Book." Accordingly, this SBOA publication is organized on the basis of these conceptual frameworks.

Part One - Minimum Level of Internal Control Standards: This part defines and details the minimum standards through which the system of a political subdivision will be evaluated for sufficient internal controls.

Part Two - Approved Personnel Training Materials: This part contains materials related to the video presentation by the State Board of Accounts on Internal Control. Also included in this section are examples of internal control procedures that could be used to meet each of the seventeen principles. Lastly, this part provides case studies of deficiencies found in SBOA audits and possible resolutions through controls. Please remember, every situation is different and will call for its own unique internal control process. There is no one static internal control process.

Because governments vary in size and complexity, no single method or set of internal control policies and procedures is universally applicable. While this manual provides minimum requirements, internal control is a dynamic open field, with information and publications that might be beneficial in helping the user tailor controls to better fit the organization's particular

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needs. While adoption of the "Green Book" is not required, we strongly suggest it as a companion guide, especially for those with oversight or internal control development responsibilities. It may be found at www.gao.gov/greenbook.

To keep informed about developments in the field of internal control, consult other professional literature, visit relevant web sites, join professional accountability organizations, and attend training programs on the subject of internal control.

DEFINITION OF INTERNAL CONTROL

By necessity, the definition of internal control is broad. Internal control is a conceptual process that is applied to a wide range of situations in a wide range of environments. The purpose of the internal control process is to provide reasonable assurance that the mission and objectives of an organization will be achieved. This purpose includes the reduction of risk associated with fraud as well as a safeguard of resources against loss due to waste, abuse, mismanagement, or errors. Internal control provides a check and balance system over operations, promoting operational effectiveness and efficiency. A system of sufficient internal control produces reliable financial and management data; ensures accuracy and timeliness in reporting; and promotes compliance with laws.

SBOA defines internal control as follows:

- *Internal control is a process executed by officials and employees that is designed to provide reasonable assurance that the objectives of the political subdivision will be achieved;*
- *It is a basic element fundamental to the organization, rather than a list of added on tasks;*
- *It is an adaptable process that is a means to an end, not an end in itself;*
- *It is focused on the achievement of objectives; and*
- *It is dependent on officials and employees for effective implementation.*

Each of the five components of internal control is necessary to form a complete internal control process: Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring Activities. If any of the five components is missing, true internal control is not achieved. Additionally, each component is comprised of recognized principle elements. To have a complete component, the principles associated with each component should be present.

Introduction

DOCUMENTATION OF INTERNAL CONTROL

Documentation is a necessary part of effective internal control. Documentation relates internal control procedures to the missions and objectives of the unit, solidifies expectations, and provides an effective way to communicate the process. Management uses judgment in determining the extent of documentation needed. However, SBOA recommends the minimum documentation requirements found in the "Green Book."

ORGANIZATIONAL ROLES

All members of a political subdivision, including all elected officials, board members (compensated or not), and employees fulfill a role in the system of internal control. However, leadership of the political subdivision sets the tone; clear support from leadership engages a successful, effective internal control system and emphasizes the importance of contributions that each individual provides as part of the team. If leadership does not effectively establish and clearly communicate support for internal control and what the internal control system is, the political subdivision will likely experience a weak, ineffective internal control system that is only sporadically successful. While these internal control standards are useful and applicable to all members, personnel as defined under IC 5-11-1-27 have been specifically charged with understanding the standards and procedures adopted by the legislative body of the political subdivision. IC 5-11-1-27 (c) provides that personnel means, "an officer or employee of a political subdivision whose official duties include receiving, processing, depositing, disbursing, or otherwise having access to funds that belong to the federal government, state government, a political subdivision, or another governmental entity."

After June 30, 2016 the legislative body of the political subdivision must ensure that the internal control standards and procedures are adopted by the political subdivision and that personnel receive the necessary training.

PROCEDURES FOR ADOPTION OF INTERNAL CONTROL POLICY AND TRAINING

At a minimum, the legislative body shall stipulate in a policy that they have adopted the internal control standards as defined by SBOA under IC 5-11-1-27(e). Personnel training of individuals shall be evidenced through a certification process. The certification form that is to be used and retained by the political subdivision is found in the Appendix of this manual. The fiscal officer of a political subdivision must certify in writing that the minimum internal control standards have been adopted and personnel, not on leave status, have received training. The certification must be filed with SBOA at the same time as the Annual Financial Report is filed, beginning in 2017.

OBJECTIVES

The achievement of objectives is the purpose of the internal control system and so the objective(s) must first be defined. In general, objectives for political subdivisions originate from purposes and functions detailed in laws,

Introduction

regulations, ordinances, etc. Objectives are set at both the entity level and at office level by the oversight body and management and must be viewed from a holistic, interrelationship approach.

There are three broad categories of objectives which help to clarify the objective setting process:

- *Operations objectives* which are designed to analyze operational and performance goals along with the effectiveness and efficiencies of operation, including the safeguarding of assets.
- *Reporting objectives* which are designed to consider both financial and non-financial information, internal and external to the unit, with an expectation of reliability, accountability and transparency.
- *Compliance objectives* which are designed to assure adherence to laws and regulations.

These objective categories are interrelated and, therefore, may overlap.

DEFINITIONS OF OVERSIGHT BODY, LEGISLATIVE BODY, AND MANAGEMENT

The oversight body and management work together and share responsibility for the development and implementation of internal controls for the political subdivision. Management is primarily responsible for the design and implementation of the internal control structure. The oversight body has the ultimate responsibility to oversee and monitor that the internal controls have been implemented and are being followed by the political subdivision as a whole.

The oversight body is by default the legislative body for each political subdivision. However, the legislative body can establish a separate oversight body. They would need to specify who or which positions will be part of the oversight body and what the responsibilities of the oversight body will be.

Each political subdivision has unique organization requirements and statutory authorities that define who is part of management and who is part of the legislative body.

County

For Counties, the legislative body is usually the Board of Commissioners. However, there are a few counties that under statute have established the County Council as the legislative body. For counties, the legislative body might want to consider establishing an oversight committee made up of representatives from the Commissioners, the Council and other office

Introduction

holders or department heads. If a county legislative body chooses to establish an oversight committee, they should also establish the composition of the oversight committee and what responsibilities they are delegating to that committee.

Management includes elected officials and department heads that design and implement controls and control activities for their office or department. As much as possible, those controls should be documented and provided to all employees. Feedback between the legislative body/oversight committee and management should be established at the beginning of the internal control process.

City or Town

For second and third class Cities, the Common Council is the legislative body. For Towns, the Town Council is the legislative body. If the legislative body for a City or Town chooses to establish an oversight committee, they should also establish the composition of the oversight committee and what responsibilities they are delegating to that committee.

Management includes elected officials and department heads that design and implement controls and control activities for their office or department. As much as possible, those controls should be documented and provided to all employees. Feedback between the legislative body/oversight committee and management should be established at the beginning of the internal control process.

School

For School Corporations, the legislative body is the School Board of Trustees. If the legislative body for a School chooses to establish an oversight committee, they should also establish the composition of the oversight committee and what responsibilities they are delegating to that committee.

Management is a combination of the Superintendent and the Finance Director (CFO, Business Manager, Treasurer, etc.) who design and implement internal controls and control activities for the School Corporation. As much as possible, those controls should be documented and provided to all employees. Feedback between the legislative body and management should be established at the beginning of the internal control process.

For Extra-Curricular Accounts, the legislative body is the School Board of Trustees. If the legislative body for the Extra-Curricular Accounts chooses to establish an oversight committee, they should also establish the composition of the oversight committee and what responsibilities they are delegating to that committee.

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Management is a combination of the Superintendent, the Finance Director (CFO, Business Manager, Treasurer, etc.), the School Principal, and the ECA Treasurer who design and implement internal controls and control activities for the Extra-Curricular Accounts. As much as possible, those controls should be documented and provided to all employees. Feedback between the legislative body and management should be established at the beginning of the internal control process.

Township

For Townships, the legislative body is the Township Board. If the legislative body for a Township chooses to establish an oversight committee, they should also establish the composition of the oversight committee and what responsibilities they are delegating to that committee.

Management is the Township Trustee who designs and implements internal controls and control activities for the Township. As much as possible, those controls should be documented and provided to all employees. Feedback between the legislative body and management should be established at the beginning of the internal control process.

Other Governmental Units

For a governmental unit not previously discussed and defined, the governing body of the unit is the legislative body. If the legislative body for another governmental unit chooses to establish an oversight committee, they should also establish the composition of the oversight committee and what responsibilities they are delegating to that committee.

Management includes elected and/or appointed officials and department heads that design and implement controls and control activities for their office or department. As much as possible, those controls should be documented and provided to all employees. Feedback between the oversight body and management should be established at the beginning of the internal control process.

Part One:

Minimum Level of Internal Control Standards

FIVE COMPONENTS OF INTERNAL CONTROL

A system of internal control may be implemented in many different ways. Because political subdivisions vary in purpose, size and complexity, no single method of internal control is universally applicable. However, the five internal control components and seventeen principles should be present and functioning, operating in an integrated manner. Some components may have principles implemented entity-wide, which impact the internal control system for all objectives, while other components may be specific to a given objective.

The terms oversight body and management are used throughout these guidelines. Please refer to the Introduction Section for the definitions appropriate to your political subdivision.

Component One: Control Environment

The control environment is the basic commonality for all and comprises the integrity and ethical values of the political subdivision established by the oversight body and management. The standards, processes, and structures which form the control environment pervasively impact the overall system of internal control. The oversight body and management convey leadership expectations, and overall tone which are reinforced by all officials and management throughout the various offices and departments. The control environment also contains the overall accountability structure for all employees through performance and reward measures. Within this structure, leadership demonstrates commitment to the political subdivision by having a process for attracting, developing, and retaining competent individuals. This component is static in that its underpinnings do not generally change with a given objective.

Five of the seventeen principles of internal control pertain to the control environment:

Principle 1. The oversight body and management demonstrate a commitment to integrity and ethical values.

The oversight body and management demonstrate these values through directives, attitudes and behavior. Established standards of conduct are expected to be observed by all throughout the political subdivision and are used when evaluating adherence to the values of the political subdivision.

Principle 2. The oversight body oversees the entity's internal control system.

There is an oversight structure in place. The oversight body oversees management's design, implementation, and operation of the political subdivision's internal control system.

FIVE COMPONENTS OF INTERNAL CONTROL

Principle 3. Management establishes an organizational structure, assigns responsibility, and delegates authority to achieve the political subdivision's objectives.

Organizational structure is designed, responsibilities are assigned and authority delegation is identified to enable the political subdivision to plan, execute, control and assess achievement of objectives. The organizational structure is designed so that it is clear where responsibilities are, especially for those areas where statute has not assigned particular responsibilities. When needed, management will go back to the legislative body to enact the policies that will clearly define these areas, specifically when the organizational structure extends beyond office or department boundaries to affect the political subdivision as a whole. Management develops and maintains documentation of the internal control system.

Principle 4. Management demonstrates a commitment to attract, develop and retain competent individuals.

Policies pertaining to the recruitment, training, mentoring, and retention of personnel consider the objectives of the political subdivision, including succession and contingency plans for key roles.

Principle 5. Management evaluates performance and holds individuals accountable for their internal control responsibilities.

Individuals are held accountable for their internal control responsibilities through a recognized, understood structure which includes corrective action procedures. Additionally, management evaluates for excessive pressures on personnel and adjusts these pressures accordingly.

**Component Two:
Risk Assessment**

Risk is the possibility that an event will occur and adversely affect the achievement of objectives. Risk assessment is the process used to identify and assess internal and external risks to the achievement of objectives, and then establish risk tolerances. Each identified risk is evaluated in terms of its impact and likelihood of occurrence. Overall, risk assessment is the basis for determining how risk will be managed.

Four of the seventeen principles of internal control apply to risk assessment:

FIVE COMPONENTS OF INTERNAL CONTROL

Principle 6. Management defines objectives clearly to enable the identification of risks and defines risk tolerances.

Objectives defined in clear terms will include information such as: who is to achieve the objective, how the objective will be achieved, and when the objective will be achieved.

Principle 7. Management identifies, analyzes, and responds to risk related to achieving the defined objectives.

Management identifies risks to the achievement of the political subdivision's objectives across the unit as a whole and within each office or department. Analysis of risk through determination of objective measures and variance tolerances is the basis for determining how the risks should be managed. The response to risk is selected: acceptance, avoidance, reduction, or sharing.

Principle 8. Management considers the potential for fraud when identifying, analyzing, and responding to risks.

The types of fraud which could impact the achievement of objectives include fraudulent financial reporting, misappropriation of assets, and corruption. As a part of this analysis, fraud risk factors are identified: pressure, opportunity, and rationalization. The response to fraud risk exercises the same process used for all analyzed risks.

Principle 9. Management identifies, analyzes, and responds to significant changes that could impact the internal control system.

Internal control is a process, and part of that process is the responsibility for management to be continually aware of changes, both external and internal, that could affect the achievement of the political subdivision's objectives. Those changes should be analyzed for both their immediate effect and for any future impact. Management would then determine any modifications needed in the internal control process to adapt to these changes.

**Component Three:
Control Activities**

Control activities are the actions and tools established through policies and procedures that help to detect, prevent, or reduce the identified risks that interfere with the achievement of objectives. Detection activities are designed to identify unfavorable events in a timely manner whereas prevention activities are designed to deter the occurrence of an unfavorable event. Examples of these activities include reconciliations, authorizations, approval processes, performance reviews, and verification processes.

FIVE COMPONENTS OF INTERNAL CONTROL

An integral part of the control activity component is segregation of duties. The fundamental premise of segregation of duties is that an individual or small group of individuals should not be in a position to initiate, approve, undertake, and review the same action. Separating the ability to record, authorize, and approve the transactions along with the handling of the related asset reduces the risk of error or fraudulent actions. It also reduces the risk of management override.

In very small governmental units, such segregation may not be practical. In this case, compensating activities should be implemented which may include additional levels of review for key operational processes, random and/or periodic review of selected transactions. These additional levels of review may take the form of managerial review of reports of detailed transactions, periodic review of performance of reconciliations, and periodic counts of assets and comparison to records. Certain situations may require management to go outside of the office or department for help in implementing controls and these reviews might be performed by governing boards or other elected officials.

There is an expectation of segregation of duties. If compensating controls are necessary, documentation should exist to identify both the areas where segregation of duties are not feasible or practical and the compensating controls implemented to mitigate the risk. Clear documentation should be maintained for continuity as well as ease of communication to outside parties.

Three of the seventeen principles of internal control apply to control activities:

Principle 10. Management designs control activities to achieve objectives and respond to risks.

Control activities are designed to fulfill defined responsibilities and address identified risks. An evaluation of the purpose of the control activity is performed as well as an evaluation of the effect a deficiency would have on objectives. Control activities may be either automated or manual. The Green Book identifies a list of control activity categories that are meant only to illustrate the range and variety of control activities; the list is by no means all inclusive, but is reproduced here for reference purposes:

- Top-level reviews of actual performance.
- Reviews by management at the functional or activity level.
- Management of human capital.

FIVE COMPONENTS OF INTERNAL CONTROL

- Controls over information processing.
- Physical control over vulnerable assets.
- Establishment and review of performance measures and indicators.
- Segregation of duties.
- Proper execution of transactions.
- Accurate and timely recording of transactions.
- Access restrictions to and accountability for resources and records.
- Appropriate documentation of transactions and internal control.

Principle 11. Management designs the political subdivision's information system and related control activities to achieve objectives and respond to risks.

Control activities are designed to support the completeness, accuracy, and validity of information processing by technology including the design of security management. Management evaluates changes to systems and updates control activities in response. For example,

- Disaster Recovery ensures that critical accounting information will be processed in the event of interruption of computer processing capacity.
- Back-Up Processing provides for accounting information to be backed up on a periodic basis sufficient to allow restoration of the information in a timely manner.
- Physical Security protects the computer system and the associated telecommunications equipment from environmental damage and unauthorized access.
- Logical Security requires access to accounting information and processes be controlled by operating system software and by the computerized accounting application through user identification codes and passwords.
- Change Controls are internal controls over changes made to the accounting system's computer programs.

FIVE COMPONENTS OF INTERNAL CONTROL

- Audit Trails allow for sufficient documentation to trace all transactions from the original source of entry into the system, through all system process, and to the results produced by the system.
- Input Controls provide input edits and controls to assure that information entered into the system is accurate, that all appropriate information is entered into the system.
- Segregation of Duties can be achieved within information technology systems by appropriate assignment of security profiles that define the data the users can access and the functions they can perform.
- Output Controls are features that assure all accounting information is reported accurately and completely.
- Interface Controls allow for Information generated in one computer application system to be transferred to another computer application system accurately and completely.
- Internal Processing provides written verification procedures and actual verification results that document accurate calculating, summarizing, categorizing, and updating of accounting information on a periodic basis.

Principle 12. Management implements control activities through policies.

Management works with each office or department in determining the policies necessary to address the objectives and related risks for the operational process. Further defined policies through day-to-day procedures may be warranted. These policies are periodically reviewed for continued relevance and effectiveness.

Component Four: Information and Communication

Relevant information from both internal and external sources is necessary to support the functioning of the other components of internal control. Communication is the continual process of providing, sharing, and obtaining necessary information. Internal communication enables personnel to receive a clear message that control responsibilities are taken seriously by the organization. External communication enables relevant outside information to be internalized and internal information to be clearly communicated to external parties.

FIVE COMPONENTS OF INTERNAL CONTROL

Three of the seventeen principles of internal control pertain to the component of information and communication:

Principle 13. Management uses quality information to achieve the political subdivision's objectives.

Management defines the types of information needed and the acceptable sources of information. Then, management processes and evaluates the information for relevancy. Information should be appropriate, current, complete, accurate, accessible, and timely.

Principle 14. Management internally communicates the necessary quality information to achieve the political subdivision's objectives.

Information is communicated using established reporting lines. Appropriate communication methods consider the audience, nature of the information, availability, cost, and any legal or regulatory requirements.

Principle 15. Management externally communicates the necessary quality information to achieve the entity's objectives.

Management identifies external parties and communicates relevant information. Appropriate communication methods are developed and should include the same consideration as outlined for internal communication.

**Component Five:
Monitoring Activities**

Evaluations are used to determine whether each of the five components of internal control is present and functioning. These evaluations may be conducted on an ongoing or periodic basis. The criteria used are developed by the oversight body, elected officials, management, governing boards, or recognized standard-setting bodies or regulators.

Two of the seventeen principles of internal control apply to monitoring activities:

Principle 16. Management establishes and operates monitoring activities to monitor the internal control system and evaluate the results.

A baseline of the current state of the internal control system is compared against the original design of the internal control system. The baseline consists of issues and deficiencies identified in the internal control system. The results of the monitoring process are evaluated and documented.

FIVE COMPONENTS OF INTERNAL CONTROL

Potential changes to the internal control system are identified. Control and monitoring activities may be the same, but it is the intent of the activity that distinguishes which component the activity is supporting. For example, a review of reconciliation with the intent to detect errors would be a control activity while a review of the same reconciliation with the intent to determine if internal control procedures are in place and functioning properly would be a monitoring activity.

Principle 17. Management remediates identified internal control deficiencies on a timely basis.

Management establishes a mechanism for personnel to report internal control issues identified while performing their responsibilities. These issues are documented and evaluated on a timely basis.

Management remediates identified issues. **Corrective actions include resolution of audit findings.**

Part Two:

Approved Personnel Training Materials Supplement

INTERNAL CONTROL SYSTEMS

Handouts for Video Presentation located on website www.in.gov/sboa

INTRODUCTION

- The information on the following slides supplement and support the PowerPoint presentation on the Uniform Internal Control Standards for Indiana Political Subdivisions. This presentation is available on the State Board of Accounts website www.in.gov/sboa
- The presentation is available in webinar format to anyone who would like to review the information.

Why do we talk about internal controls then find it difficult to take action?

- Control systems are not uniform.
- They are not tangible.

They are not rocket science but in order to be effective they have to be more than just thoughts in the mind of management.

Summary of the Discussion

- Understanding Internal Control
 - 3 Categories of Objectives
 - 5 Components on Internal Control Systems
 - COSO/Green Book
 - Expanded guidance on the role of those in charge of governance in Internal Control Systems
 - Adjusted for increased dependence on IT
 - 17 principles under the 5 components
- Implementation

Definition of Effective Internal Control

An effective system of internal control requires that:

- Each of the 5 components and 17 principles are present and functioning and,
- The 5 components operate together in an integrated manner.

A major deficiency exists if the county cannot conclude that these are met.

Internal Control Framework



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Management's Objectives

- Operations
- Reporting
- Compliance



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Internal Control Components

- Control Environment
- Risk Assessment
- Control Activities
- Information & Communication
- Monitoring Activities



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Control Environment

- Set of standards, processes, and structures
- Tone at the top
- Integrity and ethical values of the political subdivision
- Includes performance measures, incentives, and rewards

Acts as the foundation for a sound system of internal control

Risk Assessment

Risk assessment requires management to consider the impact of possible changes in the external environment and within the political subdivision that may render internal control ineffective.

- Many organizations, take a risk-based approach to internal control
- Includes:
 - Risk Identification
 - Risk Analysis
 - Risk Response

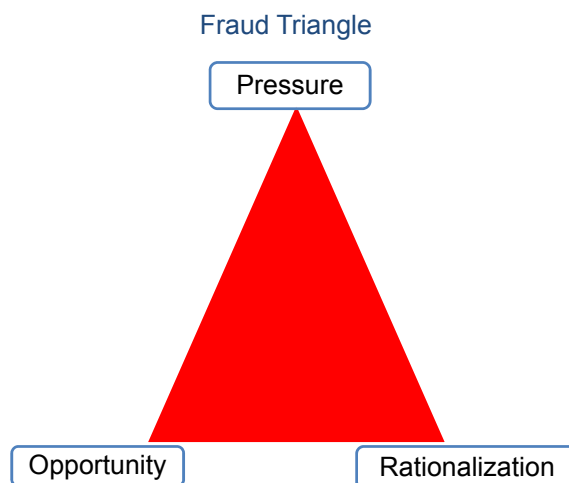
Control Activities

Control activities are the actions established through policies and procedures to mitigate risks to the achievement of objectives.

- Preventive or detective in nature
- Manual and automated activities
- Includes segregation of duties

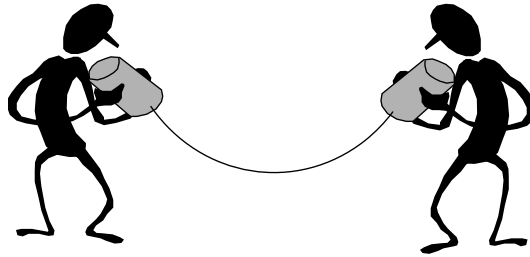
Internal controls combat fraud and mistakes

- Prevent Opportunity
- Detect Fraud, Errors and Omissions



Information and Communication

- Emphasizes importance of quality information
- Volume and sources
- Complexity of processes
- Technology advances
- Greater interaction with 3rd party vendors



Monitoring Activities

Ongoing Evaluations

- Built into the business process at various levels
- Timely information

Separate Evaluations

- Conducted periodically
- Frequency will depend on assessment of risks and effectiveness of ongoing evaluations

New Principles

COSO/Green Book clarifies requirements for effective internal control with the 17 new principles

- Principles relate to a component of the internal control system
- Common sense

Control Environment

1. The oversight body and management demonstrate a commitment to integrity and ethical values.
2. The oversight body oversees the entity's internal control system.
3. Management establishes an organizational structure, assigns responsibility, and delegates authority to achieve the political subdivision's objectives.
4. Management demonstrates a commitment to attract, develop and retain competent individuals.
5. Management evaluates performance and holds individuals accountable for their internal control responsibilities.

Risk Assessment

6. Management defines objectives clearly to enable the identification of risks and defines risk tolerances.
7. Management identifies, analyzes and responds to risk related to achieving the defined objectives.
8. Management considers the potential for fraud when identifying, analyzing and responding to risks.
9. Management identifies analyzes, and responds to significant changes that could impact the internal control system.

Control Activities

10. Management designs control activities to achieve objectives and respond to risks.
11. Management designs the political subdivision's information system and related internal control activities to achieve objectives and respond to risks.
12. Management implements control activities through policies.

Information and Communication

13. Management uses quality information to achieve the political subdivision's objectives.
14. Management internally communicates the necessary quality information to achieve the political subdivision's objectives.
15. Management externally communicates the necessary quality information to achieve the entity's objectives.

Monitoring Activities

16. Management establishes and operates monitoring activities to monitor the internal control system and evaluate the results.
17. Management remediates identified internal control deficiencies on a timely basis.

Take it Step by Step and see where it leads you!

1. Control Environment
2. Risk Assessment
3. Control Activities
4. Information and Communication
5. Monitoring

Documentation

Start with documenting the 5 components in significant areas first.

- Cash handling
- Management's Goals
 - Customer Service
 - Compliance with Laws and Regulations

Find where there is risk that is not mitigated by internal control

- This is Risk identification
- Perform your risk analysis
- Respond to the risk
 - Implementing controls
 - Insurance
 - Acceptance of the Risk



Are you going to “trust” or “make sure” things are done right in your office?

Examples of Internal Control Procedures

INTRODUCTION

Governments provide services to their citizens. Locally these services can include public safety, education, highways and streets, health and welfare, culture and recreation, economic development and public utilities. In order to fund those services, governments procure resources through taxation, fees, fines, permits/licenses, donations and grants from other governments. Governments must aim to make the most effective and efficient use of these resources in rendering services. A sound internal control system provides reasonable assurance that a political subdivision will accomplish its mission and objectives with accountability and transparency.

This section contains ideas of policies, procedures and other considerations for the development and implementation of a reliable internal control system. However, this section should not be construed as a prescribed system of internal control. The oversight body and management are responsible for developing and implementing an internal control system which meets the needs of the political subdivision.

Component One: Control Environment

The control environment sets the tone of the organization and influences the effectiveness of internal controls within the government. Many factors determine the control environment, including the oversight body's attitude, actions, and values; commitment to competence and human resource policies and practices; assignment of authority and responsibility; and participation.

Principle 1. The oversight body and management demonstrate a commitment to integrity and ethical values.

As part of its commitment to an overall system of internal control, the oversight body develops and implements a formal ethics policy. In order to ensure the policy is communicated to each person, a system of annual acknowledgment could be devised; for example, through e-mail submission or manual documentation, each official and employee attests they have read the policy and will adhere to the policy.

In furtherance of its commitment to integrity and ethical values, the oversight body and management consider the following procedures:

- Conveying periodic messages of philosophy and expectations to all employees.

Examples of Internal Control Procedures

- Evaluating the internal control system for weaknesses on a regular basis, providing resolutions to any weaknesses, and informing employees of changes in procedure.
- Establishing a confidential reporting system for individuals to report suspected fraud and abuse of local policies.
- Instituting procedures to address violations of policies and consequences for violation.

Principle 2. The oversight body oversees the entity's internal control system.

If considered necessary, the legislative body establishes an oversight committee and appoints members with high ethical values, excellent communication and problem solving skills. This committee oversees the internal control system and advises the legislative body and management on internal control issues. In the event that an oversight body is not created, the legislative body would be responsible for overseeing the internal control system for the entity.

Management provides documented control processes to the oversight body for review and input. The oversight body should analyze the internal control system for weakness on an entity-wide basis as well as on a departmental basis. Ideally, offices and departments utilize the oversight body as a resource for ideas.

To ensure inclusion of all components in the internal control system, the oversight body provides a template of the five components with corresponding principles to each person responsible for the achievement of a defined objective. The point person for a particular objective shows modifications for those areas that are directly related to the objective.

Principle 3. Management establishes an organizational structure, assigns responsibility, and delegates authority to achieve the entity's objectives.

Management establishes and documents the organizational structure of each office and department. Examples of items to incorporate into the structure include:

- An organizational chart.

Examples of Internal Control Procedures

- An outline of specific duties within the organizational structure.
- Designation of responsible persons for each part of the accounting process.
- Documentation of internal control procedures over specific accounting areas, including communication and monitoring.
- Correlation of assigned responsibility and authority to entity objectives.

Principle 4. Management demonstrates a commitment to recruit, develop, and retain competent individuals.

Management determines the skills necessary for each level of the organizational chart and assesses each employee for skills necessary to accomplish the assigned responsibilities. The oversight body develops a plan to continually train employees on new procedures, laws, and governmental guidelines. Items to consider include:

- Creating job descriptions and determining skills necessary to perform jobs.
- Tracking the training schedules and review courses for each employee.
- Completing evaluations on a regular basis and addressing any deficiency in skills.
- Assessing the best recruitment pools for the differing skill sets of skills, i.e., interviewing at job fairs, colleges, internship programs, etc.

Principle 5. Management evaluates performance and holds individuals accountable for their internal control responsibilities.

Management develops a formal employee evaluation system to assess the performance of each employee's internal control responsibilities.

The oversight body establishes overall policies with objectives that cross over offices and departments. Examples might be grant coordination, claims processing, and personnel and payroll procedures.

Examples of Internal Control Procedures

Management establishes communication procedures to ascertain weaknesses in internal controls as well as non-compliance with internal control procedures. For example, communications may be received internally from other employees or externally from citizen complaints or issues. Procedures may include a mechanism for responding to these communications, including communication back to the employee who was non-compliant with procedures.

Management and the oversight body work together to address noncompliance with internal control procedures and take appropriate action to correct the noncompliance.

Component Two: Risk Assessment

Risk assessment is the process used to identify, analyze, and manage potential risks to the governmental entity's objective. When performing a risk assessment, management considers the effects of change and inherent risk.

During times of change, events can occur that expose the government to increased risk, such as change in management or responsibilities of management; rapid growth; new technology or information systems; or new programs or services. Certain activities have a greater potential for loss from fraud, waste, unauthorized use, or misappropriation. For example, the handling of cash has a much higher inherent risk for theft than data entry activities. When evaluating inherent risk, some items to consider include:

- The complexity of the activity itself or the calculations for the activity.
- The susceptibility of the activity to fraud or misappropriations.
- The extent of judgment involved for the activity.
- The size and volume of individual items comprising the activity.

Once identified, risks should be analyzed for likelihood and impact. Many risks are accepted or avoided by implementing effective controls.

Examples of Internal Control Procedures

Principle 6. Management defines objectives clearly to enable the identification of risks and risk tolerances.

Objectives fall within three major categories:

Operations - Effectiveness and efficiency of operations.

Reporting – Reliability of reporting for internal and external use.

Compliance – Compliance with applicable laws and regulations.

As a part of this process, the oversight body may consider the following:

- Defining objectives in specific measurable terms in order to enable the design of internal control for related risks, to increase understanding at all levels, and to assess performance.
- Identifying what is to be achieved, who is to achieve it, how it will be achieved, and when it will be achieved.
- Incorporating external requirements, such as state statutes and Uniform Compliance Guidelines.
- Including a subset for the three categories which addresses the safeguarding of assets.

Principle 7. Management identifies, analyzes, and responds to risks related to achieving the defined objectives.

In the identification process, management recognizes the various types of risks at the entity and transaction levels for each objective. For example, risk factors may include the organizational structure, new technology, complexity of a program or transaction, new or amended laws, or economic instability.

Management analyzes identified risk to estimate the effect of the risk on achieving the defined objectives at the entity level and transaction level. For example,

- How likely is the risk to occur?

Examples of Internal Control Procedures

- How will it impact the objective?
- Is the risk based on complex or unusual transactions?
- Is the risk based on fraud?

Risks may be analyzed individually or collectively. Once the risks have been identified and analyzed, management determines how to respond to each risk and design specific actions accordingly. For example, management may accept the risk and take no action in response; choose to eliminate certain processes to avoid the risk; reduce the risk by instituting controls; or transfer the risk. Certain responses to fraud risk are required by statute, such as the purchase of official bonds.

Principle 8. Management considers the potential for fraud when identifying, analyzing, and responding to risks.

Management considers the types of fraud which can occur, such as fraudulent financial reporting, misappropriation of assets, and illegal acts. In addition to fraud, management assesses the likelihood of other types of misconduct such as waste or abuse. Various risk factors may need to be evaluated as well as allegations from internal or external parties.

The analysis and response to fraud risk is similar to the procedures set for in the analysis and response to risk in Principle 7. Certain responses to discovered fraud are required by statute:

- IC 5-11-1-27(l) Report of Misappropriation of Funds to State Board of Accounts and Prosecuting Attorney.
- IC 5-11-1-27(j) Report of Material Variances, Losses, Shortages, or Thefts to the State Board of Accounts.

Principle 9. Management identifies, analyzes, and responds to significant changes that could impact the internal control system.

Internal control procedures require evaluation and adjustment on a regular basis to accommodate the impact of future changes; for example, personnel changes, newly elected officials, new programs, new technology, new laws, and financial fluctuations. For example,

Examples of Internal Control Procedures

- New employees receive training on internal controls and employee policies.
 - New software requires a reevaluation of policies and procedures to determine if existing controls will continue to be effective and if new controls need to be designed and implemented. (Procedures that worked well under a manual or a previous software system may no longer be applicable under the new system).
 - A change in reporting requires a review of internal controls over the compilation of the report.
-

Component Three: Control Activities

Once risks are identified and assessed, management develops control activities to minimize the risks. Control activities detect, prevent, or reduce the identified risks that interfere with the achievement of objectives. Detection activities are designed to identify unfavorable events in a timely manner whereas prevention activities are designed to deter the occurrence of an unfavorable event. Examples of these activities include reconciliations, authorizations, approval processes, performance reviews, and verification processes.

An integral part of the control activity component is segregation of duties. However, in very small governmental units, such segregation may not be practical. In this case, compensating activities should be implemented which may include additional levels of review for key operational processes, random and/or periodic review of selected transactions. In smaller units, these reviews and testing of processes might be performed by governing boards or other elected officials.

Principle 10. Management designs control activities to achieve objectives and respond to risks.

Management tailors control activities to the functions of the political subdivision and documents the required procedures. The following examples of control activities are categorized by transaction type; the list is not all inclusive and would not necessarily comprise a complete internal control system.

Examples of Internal Control Procedures

A. Payroll Activities

1. Salaries and wage rates are verified by someone outside of the payroll process.
2. The responsibilities for hiring, terminating, and approving promotions are segregated from those preparing payroll transactions or inputting data.
3. The responsibilities for approving time sheets are segregated from those for preparing payroll transactions or inputting data.
4. Payroll adjustment reports are reviewed by someone outside of the payroll process.
5. Employees' time and attendance records are approved by their supervisors.
6. Corrections to recorded time and attendance records are approved by the employee's supervisor and authorized by management.
7. Procedures are in place to ensure that changes in employment status are promptly reported to the payroll processing unit.
8. Payroll disbursements are reviewed and approved by an authorized individual prior to payment.
9. Access to payroll applications is appropriately controlled by user logins and passwords.
10. Changes to a payroll disbursement are approved by an individual other than the ones authorized to make the changes.
11. Payroll checks are accounted for in numerical order and reconciled to the payroll check register.
12. Access to the signature stamp used to sign payroll checks is adequately controlled.
13. Payroll checks/stubs are periodically distributed by someone outside the normal payroll distribution function.

Examples of Internal Control Procedures

14. Unclaimed payroll checks/stubs are returned to an individual other than those involved with the payroll process.
15. Employees are cross-trained on the payroll process; those assigned to payroll take mandatory vacations.

B. Disbursement Activities

1. The responsibility for approving claims is segregated from those preparing the claims.
2. Checks are written by an individual other than the one approving the claim.
3. Checks are signed by an individual other than the one preparing them.
4. Claims for payment are reviewed and approved by the governing body prior to payment.
5. A reconciliation is completed between the claims for payment approved by the board and the actual disbursements posted to the ledger.
6. The responsibility for acknowledging the receipt of goods or services is segregated from those preparing claims and writing checks.
7. Vendor checks are accounted for in numerical order and reconciled to the disbursement ledger.
8. Invoices or other receipts are attached to each claim to support the disbursement.
9. A review is completed by an individual outside the disbursement process in which the claim amount is compared to the supporting documentation attached to the claim and the amount of the check.
10. Access to disbursement applications is appropriately controlled by user logins and passwords.

Examples of Internal Control Procedures

C. Receipting Activities

1. The responsibility for collecting money and issuing receipts is segregated from those preparing the bank deposit.
2. The responsibility for making bank deposits is segregated from those preparing the monthly bank reconciliation.
3. Pre-numbered receipts are issued for all money collected and the duplicate receipt is retained.
4. Receipts are reconciled to the cash receipts ledger by an individual other than the one collecting money and issuing receipts.
5. Posting of receipts to the ledger is completed by an individual other than the one who collects money and makes the deposit.
6. Receipts indicate the type of payment received (cash, check, etc.) and this is reconciled to the make-up of the bank deposit.
7. Accounts receivable records are maintained by an individual other than the one(s) involved in the billing process.
8. The billing process is completed by an individual other than the one who collects cash payments from customers.
9. Adjustments to customer accounts are approved by the governing body only after a thorough review.
10. A periodic review is completed of all adjustments made to customer accounts by an individual independent of the billing and accounts receivable processes to ensure that all adjustments made have proper approval from the governing body.

D. Cash Activities

1. A reconciliation between the recorded cash balance and the bank balance is completed monthly by an individual separate from the receipting and disbursing processes.

Examples of Internal Control Procedures

2. A reconciliation between the receipts ledger and the credits to the bank account is completed periodically by an individual separate of the receipting process.
3. A reconciliation between the disbursement ledger and the debits to the bank account is completed periodically by an individual separate of the disbursement process.
4. The monthly reconciliation between the cash balance and the bank balance is thoroughly reviewed and approved by the governing body.
5. Disbursements from and reimbursements to petty cash funds are periodically reviewed by an individual other than the one responsible for maintaining the petty cash fund.

E. Credit Cards Transactions

1. A designated official or employee oversees the issuance and use of the credit cards.
2. An ordinance or resolution specifically states the purposes for which the credit card may be used.
3. The designated official or employee collects the credit card when the purpose for which the credit card has been issued has been accomplished.
4. The designated responsible official or employee maintains an accounting system or log which includes the names of individuals requesting usage of the cards, their position, estimated amounts to be charged, fund and account numbers to be charged, date the card is issued and returned, sufficient documentation provided, etc.
5. A designated person separate from disbursement process reviews transactions listed on the credit card statements for sufficient documentation and inclusion in claim to the Board.

Examples of Internal Control Procedures

Principle 11. Management designs the political subdivision's information system and related control activities to achieve objectives and respond to risks.

Management may utilize Information technology (IT) systems as an integral part of the internal control system. In many cases, IT systems are used to record all financial information for a governmental entity. In these instances, the IT system may provide many different internal controls over the financial reporting process. For example:

- Permissions can be set that allow only certain users to perform certain tasks.
- Segregation of duties can occur by forcing duties to be completed by different users. For example, the system could be set to only allow User A the ability to generate receipts when money is received and only allow User B to post the receipts generated to the ledger. User B could check the receipts issued against the bank deposit to ensure that all receipts collected were deposited. Then, User B could post all the receipts to the ledger.
- The automation of processes and calculations enhances the internal control system by preventing errors. For example, posting receipt and disbursement amounts to the ledger and calculating fund balances and total receipts and disbursements may be completed automatically by the IT system. Once management verifies that the IT system has been set to ensure these procedures and calculations are completed correctly, reliance may be placed on the processes as a part of the internal control structure.

It must be noted that the use of an IT system can also create risks to the internal control structure. The procedures and calculations performed by the IT system must be checked to ensure they are functioning properly. Reliance on the IT system to perform these functions without verification of the accuracy can result in inaccurate reports and information. In addition, the IT system must also be adequately protected from

Examples of Internal Control Procedures

unauthorized use to avoid the recording of unauthorized transactions or unauthorized changes to existing data. Also, safeguards must be established to prevent loss of data in the event of a failure of the IT system. In view of these risks, the following steps may be considered as part of the internal control system:

- Limiting the authority to access different components of the software to employees with duties specifically related to that component.
- Prohibiting User ID and password sharing between employees.
- Restricting the authority to correct or make adjustments to the records on the system to key employees or management.
- Requiring the use of prescribed forms or the approval of alternative forms.

All of these considerations, both the benefits and risks, must be weighed by the governmental entity when deciding whether or not to make the IT system a part of the internal control structure.

Principle 12. Management implements control activities through policies.

Management establishes policies in sufficient detail to address all identified risks. Procedures are communicated in writing to all employees that are part of the financial or reporting process. Policies set out the expectations of the oversight body and management and procedures specify the specific actions needed to comply with the policy. For example, a travel policy may require out-of-state travel to be approved in advance. The procedures outline the steps to obtain and document the approval for the claim process. In addition, management may consider the following:

- The employee handbook is provided online or in hard copy and includes internal control.
- Internal control procedures are written and available to all employees.

Examples of Internal Control Procedures

- Variances from established procedures are brought to management's attention.
 - The legislative body formalizes procedures by review and adoption during a public meeting.
 - Policies and procedures are provided to other departments that are part of the financial or reporting process.
 - Templates are provided for frequent procedures that document the required procedures and adherence to the procedures such as travel, credit card purchases, employee reimbursements, etc.
-

Component Four: Information and Communication

An internal control structure must provide for the identification, capture, and exchange of information within the government and with external parties. Internal communication allows supervisors to convey responsibilities and issues to their staff. In turn, staff and middle management alert upper management to potential problems; administration and program staff communicate requirements and expectations to each other. Effective communication also encourages employee involvement. In regard to external communication, management relies on the information system, including the accounting system, to accurately report activities to the Legislature, oversight agencies, and federal grantors.

Principle 13. Management uses quality information to achieve the political subdivision's objectives.

Information must be relevant and of high quality. The appropriate statutes, regulations, grant requirements, local ordinances, and internal reports must be the most current information available. Management determines the information needed to evaluate the internal controls established. Those needs for information are communicated to the employees so that only the most relevant and reliable information is used in the internal control procedure evaluations. The oversight body also implements policies to facilitate the flow of communication between offices or departments. The oversight body is made aware of any changes to reporting or compliance requirements that would require adjustments to the internal controls over information and communication.

Examples of Internal Control Procedures

Principle 14. Management internally communicates the necessary quality information to achieve the political subdivision's objectives.

In establishing a process of internal communication, management may consider the following:

- The form of communication and documentation of internal communications between offices, departments and the oversight body is established and communicated to employees.
- Procedures are established to ensure that the communication requirements are being followed and necessary information is being communicated properly.
- Procedures are established for feedback on and clarification of the information provided.
- Internal memos and reports are maintained to document communication.

Principle 15. Management externally communicates the necessary quality information to achieve the entity's objectives.

In establishing a process of external communication, management may consider the following:

- Communications with State Board of Accounts, other State agencies, grantor agencies, regulatory agencies are documented by email, memos, letters and other correspondence.
- Logs are kept for information provided verbally.
- Procedures are established to retain public documents.
- Reports are cross checked for accuracy, relevancy and timeliness of information.

Component Five: Monitoring Activities

Monitoring activities allow management to assess the quality of internal controls over time and make adjustments as necessary. Proper monitoring ensures that controls function properly.

Examples of Internal Control Procedures

Principle 16. Management establishes and operates monitoring activities to monitor the internal control system and evaluate the results.

When establishing a monitoring system, management may consider the following procedures:

- Periodic checks are performed to determine if controls are in place and working effectively.
- Control activities are reviewed to determine if the actual activities are in compliance with established procedures.
- Deficiencies in the internal control process are documented and remediation is quickly completed to address any deficiencies.

Many of the control activities can also be used as monitoring activities with the only change in the intent of the control. For example, reviewing a bank reconciliation for accuracy and supporting documents is a control activity; reviewing a bank reconciliation to ensure that appropriate personnel completed and reviewed the reconciliation in accordance with internal control procedures is a monitoring activity. Monitoring activities should be documented by signatures, initials or other methods.

Principle 17. Management remediates identified internal control deficiencies on a timely basis.

Internal control deficiencies may be identified internally through monitoring or externally through audit reports, communication from grantor agencies, etc. Once identified, management addresses deficiencies immediately through the development of formal or informal corrective action plans. Management and the oversight body work together to ensure the corrective action plan is implemented and the resulting changes are effective in correcting internal control weaknesses.

Management and the oversight body meet regularly to discuss controls, weaknesses and corrective action plans.

Examples of Internal Control Procedures

CONCLUSION

A sound internal control system provides reasonable assurance that a political subdivision will accomplish its mission and objectives with accountability and transparency. The examples of this section provide guidance on the types of policies which could be implemented as part of an internal control system. However, the oversight body and management possess the ultimate responsibility for the design and implementation of an internal control system.

Case Studies

INTRODUCTION

The following case studies are taken from actual audit reports. We have included possible internal control procedures that if implemented could have helped the unit prevent or detect and correct these types of errors. The background and audit findings are real; however, the responses are suggestions only and not the required controls or the only possible controls. Each political subdivision is unique and no one response would work for each. Based on the needs of the unit, management and the oversight body will develop a unique internal control system that may include some of the suggestions as listed, or modifications of these suggestions, or internally developed controls that address the risks that management has identified. Some of the suggested controls refer to Indiana statutes and Uniform Compliance Guidelines which are required procedures. Internal controls should exist to ensure that the political subdivision is in compliance with Indiana statutes and Uniform Compliance Guidelines.

CASE STUDY - RECEIPTING

Background

A new Clerk of the Circuit Court was elected and no changes were made to the procedures or controls for the office. Multiple employees had access to all cash drawers in the office. The software system recorded collections to Drawer 1 and Drawer 2 and did not require identification of a specific employee with each transaction. A procedure was established where only two people, the office holder and the security administrator had access to the employees' user id's and passwords. Each employee had a unique user id and password with the exception of the 'Cash Drawer' id and password which were shared by all employees. All employees had access to all areas of the accounting system and all employees had the authorization to void transactions on the system and even the "cash drawer" user id could void a transaction. There were no established procedures to review or approve voids. Adjustments could be made to the system by all employees. There were no procedures establishing a segregation of duties in the receipting process. No paper receipts were issued for payments received and all receipting was internal to the system. There were no procedures to ensure that receipts were posted and it was assumed the bookkeeper would take care of the posting. The bookkeeper was assigned the job duties of posting, depositing and reconciling as well as being able to collect receipts.

Case Studies

Audit Results

The bookkeeper for the office was receipting cash receipts but not depositing all of the cash collections received. Because the internal controls over receipting had material weaknesses in them she was able to manipulate the records to cover her theft. In some instances, she was substituting checks to make up the for the cash collections that were misappropriated. In some cases, she would issue the receipt and then void the receipt to cover collections not deposited. Occasionally, a journal entry to adjust revenue, shown as a negative receipt, was used to cover the theft of collections. It was also discovered that the original deposit slips were altered after preparation so that the duplicate deposit slips showed a different deposit amount than what the bank received and credited to the account. Finally, source documents and revenue report for daily collections were not retained by the office and were not available for audit or for any review by the office holder.

After inspection of the bookkeeper's work computer it was discovered that she had access to every other employee's user id and password. Since cash drawers were shared among multiple employees, it was not possible to know who had actually completed the transactions. In some cases it was noted that a user id and password showed an employee making a receipt on a day that the employee was not working. Hard copy receipts were not completed so the only source documentation was the information on the computer. As a result, specific transactions could not be identified to a particular employee. Voids could be completed by any employee as there was no restriction in the rights assigned to each employee. Adjustments could be made by any employee in the system. No secondary oversight of voids or adjustments was made by anyone in the office. The bookkeeper was able to collect the payment, manipulate the system's receipting records, prepare and then alter the deposit slips, and make the bank deposit. Since she was also the person who performed the reconcilements, none of the errors or theft was detected.

Over the course of a just under three years, \$75,333 was shorted from the deposits for the political subdivision. The first year, \$9,042 was missing. This increased in the second year to \$30,682 missing, and for nine months of the third year, prior to being discovered, \$35,609 was missing.

Case Studies

Possible Controls:

**Component One:
Control Environment**

The office holder/department head should establish an organization structure for the receipting process and provide a written copy to each employee. The structure should clearly assign each employee's duties and responsibilities. Emphasis should be made to establish the importance of ethics and integrity in completing all job responsibilities, such as:

A. The policy for the county is that all public funds are entrusted to the county and that trust should not be broken. This policy is clearly stated and communicated. (Principle 1)

B. This unit is committed to integrity in providing services and an ethics policy has been written and provided to each employee. (Principle 1)

C. Internal Controls over receipting including all five components have been reviewed by the oversight body and approved. (Principle 2)

D. An organizational chart is compiled and individual job duties are outlined. (Principle 3)

E. If an employee has greater access than is needed to complete their assigned duties, that access is restricted. Cross training is completed to make sure that more than one employee is knowledgeable about the receipting process. This cross training would allow more than one employee to be aware of potential design deficiencies in the internal controls or of noncompliance with internal controls. Each employee should be encouraged to report these situations to management or the oversight body. (Principle 4)

F. Evaluations include a focus on adherence to established control procedures and skills are assessed against the employee's job responsibilities. Any additional tasks assumed by the employee are questioned. Violations are noted and corrective action is taken. Additional training is completed as necessary. All evaluations include a discussion of the internal controls and any problems the employee has with their own or another employees tasks related to internal controls.

Case Studies

Corrective action is taken whenever necessary. Internal controls are modified as needed. Control deficiencies are communicated to the oversight body along with the corrective action plan. (Principle 5)

Component Two: Risk Assessment

The objectives are that all collections should be properly receipted, and timely deposited to safeguard the assets. In addition, proper posting is necessary to achieve accurate financial reporting. There are deposit laws and receipting requirements under the Uniform Compliance Guidelines with which the unit must comply. The following are suggested procedures:

A. The objective is for all collections to be deposited timely and intact and receipts to be properly issued. There is zero tolerance for theft and minimal tolerance for error. The financial ledgers, including the revenue ledger, must be up to date and accurate to provide management and the oversight body correct information. Laws regarding deposits must be followed and funds must be posted correctly to allow for proper use of the funds in compliance with statute or ordinance. (Principle 6)

B. There is a risk that errors in receipting or posting might occur and not be detected and corrected or prevented from occurring. There is a risk that the funds ledger could be incorrect and fund balances not accurate. If receipts are not posted to the correct fund, revenue or cash balances would be inaccurate and the provision of services may be impaired. (Principle 7)

C. There is always a risk, especially with cash collections, that the collections may be misappropriated prior to deposit. The records could be manipulated to cover the theft of collections. Job duties, segregation of duties and review processes should be implemented to ensure that an employee is not able to steal collections and cover up the theft. (Principle 8)

D. At the time that the office holder began in this office, internal controls should have been reviewed and evaluated. Any deficiencies that are identified should be corrected. All employees should be trained on the process and internal control procedures. New employees who do not understand the receipting process would be unable to detect problems. Without training, employees may not be aware of the reason certain

Case Studies

controls are in place such as the requirement that passwords should not be shared and no employee should have another employee's password. Changes in software or whenever there is a change in department head or other employee means that the office or department is at a heightened risk of control systems not being followed. (Principle 9)

**Component Three:
Control Activities**

Management should establish control activities that minimize the risks identified, such as:

A. Only one employee is assigned to each drawer. The employee is responsible for balancing their drawer. No other employee is authorized to use that drawer. (Principle 10)

B. Each employee will have a user id and password, these will not be shared. (Principle 10 & 11)

C. One employee will check the reconciliation of the cash drawer collections and cash change to the revenue report for that employee. (Principle 10)

D. The IT department will be consulted so that each employee is restricted in access within the software system to those areas needed to complete assigned duties only. (Principle 10 & 11)

E. All transactions will carry the unique user id of the employee that completed the transaction. (Principle 10 & 11)

F. Only the security administrator for the office/department will have access to user id's and passwords. The security administrator does not collect receipts. (Principle 10 & 11)

G. Voided transactions require second party review and authorization. A review of all voided transactions is completed by the office holder. (Principle 10)

H. Adjustments to the revenue ledger require second party review and authorization. All adjustments are reviewed by the office holder. (Principle 10)

Case Studies

I. One employee will prepare the bank deposit. A second employee will recheck the accuracy of the deposit and a third employee will make the deposit at the bank. Duplicate receipts are returned to the employee who performs the reconciliation. (Principle 10)

J. All revenue reports will be initialed by the employee and the second party reviewer and compared to the total revenue report for the day. All reports will be maintained in a daily file. (Principle 10)

K. The office holder/department head will obtain the bank statement and review. One employee will prepare the monthly reconciliation between the bank statement and the monthly revenue report. All deposits will be traced from the bank statement back to the duplicate deposits. Any variances will be noted for immediate review. (Principle 10)

L. Receipting procedures are documented in writing and available to all employees in the office or department. Employees are encouraged to report problems they perceive in the implementation of internal controls. (Principle 12)

Component Four: Information and Communication

Both the oversight body and management foster an environment of open communication and feedback on the internal control system strengths and weaknesses as well as any deviations. For example,

A. Reconciliation of receipts to bank is completed and any corrections noted are posted to the revenue ledger and funds ledger prior to month end reports being prepared. (Principle 13)

B. All variances are researched and resolved and proper documentation is maintained. (Principle 13)

C. Reports are checked for accuracy and that corrections have been made for any errors detected. (Principle 13)

D. Management and the Oversight Body reviewed the controls over receipting and month end reports for reasonableness. Management and Oversight body respond to any complaints from employees or citizens on the receipting process. (Principle 14)

Case Studies

E. Any modifications to the receipting procedures are immediately communicated to the staff. A change in job duties may be implemented for any part of the receipting process that have been determined to have a problem. (Principle 14)

F. All control deficiencies identified in an external audit are immediately addressed, evaluated and a corrective action plan is written. Management and the oversight body will follow up on the correction plan to ensure that it has been implemented and has correctly addressed the weaknesses. (Principle 15)

**Component Five:
Monitoring Activities**

Office holder/department head should spot check bank reconcilements, cash drawer counts, receipts for the month throughout the month. Clearly identify if controls are being used as designed and look for any noncompliance with established procedures:

A. Office holder/department head reviews completed bank reconcilements each month and initial off that the reconciliation has been checked. (Principle 16)

B. Revenue reports generated from the months receipts are sent to the department head/office holder for review for accuracy and reasonableness. Monthly revenue is compared to prior months and same month from a year ago to determine reasonableness. (Principle 16)

C. Any violations of policies and procedures will be noted and evaluated. Internal Controls may be reevaluated to correct the problems discovered. (Principle 17)

CASE STUDY – RECEIPTING (Small Unit)

Background

The town used a computer software system to record billings and collections of utility services provided to its citizens. The setup of the computer system authorized the Clerk-Treasurer and two other employees to make entries to the individual citizen accounts. According to the Clerk-Treasurer, at the end of each day the Utility Clerk or the

Case Studies

Deputy Clerk-Treasurer was responsible for running the End of Day Report, totaling the payment stubs, and balancing the cash drawer. She would then complete the bank deposit ticket, and finally take the deposit to the bank. For days in which the Utility Clerk performed the End of Day duties, the Deputy Clerk-Treasurer was supposed to verify that the End of Day report, adding machine tape, cash drawer, and deposit agreed and vice versa. Each Clerk was supposed to initial off on the supporting documentation to indicate that the verification had been completed. The computer software system required each user to have a user id and password. Each payment that was posted indicated a Clerk that supposedly made the entry. The payment posting would automatically be recorded in the Customer Account history portion of the system, which the town employees were not aware of.

The town used a manual system for collecting and recording utility meter deposits. When a new customer requested utility services, they were required by a town ordinance to complete an application and pay a specific meter deposit amount. According to the Clerk-Treasurer, all employees were authorized to accept applications and payments. When the town employee was presented with an application, they calculated the meter deposit, accepted payment, and completed a two-part hand written receipt. The first copy of the receipt was given to the customer and the second part was retained in the receipt book. The employee was also required to note on the application the payment amount, date, and receipt number. The payment was entered into the town's financial computer system that would create a receipt to document posting to the appropriate fund. The employee responsible for accounting for the day's collections used the computer generated receipts to compile the bank deposit. The town also maintained a manual "Guarantee Deposit Register" where they would record meter deposits collected, released/refunded, and held.

Audit Results

We found the End of Day and verification procedures were not performed consistently enough to be effective. However, when we compared the user id noted on various reports to time cards for each clerk we found instances in which the person's user id noted was not actually working on that particular day. We concluded that the town employees were not maintaining confidentiality of their username and passwords. We found that the employees were not aware that the

Case Studies

payments they entered were recorded on the Customer History reports. We traced payments posted from the Customer History reports to the actual bank deposits and found \$47,057.31 in posted payments that were not deposited in the Town's bank account.

We found that \$3,300.00 of hand-written receipts and postings to the "Guarantee Deposit Register" were not deposited in the Town's bank account.

Possible Controls:

**Component One:
Control Environment**

A. The elected officials (Town Council and Clerk-Treasurer) could clearly express the expectations they have for all employees to conduct themselves and complete their duties with integrity. (Principle 1)

B. It appeared that the Clerk-Treasurer had assigned duties, but could have made them more specific and stressed the importance of the tasks being segregated. (Principle 3)

C. The Town Council could have reviewed the duties assigned by the Clerk-Treasurer and periodically meet with her to evaluate the office procedures and the employees that are completing those tasks. (Principle 2)

D. The Clerk-Treasurer could have required that each employee that accepted payments have their own cash drawer. (Principle 3)

E. She could have relayed the importance of each employee not sharing their usernames and passwords. She could have understood the computer accounting system and used any built-in security measures to establish and evaluate procedures. (Principle 3)

F. The Clerk-Treasurer and the Town Council could develop education and experience guidelines to use during the hiring process in order to guide them in employing competent individuals. (Principle 4)

Case Studies

G. The Clerk-Treasurer could establish an annual employee evaluation process to determine areas in which the town employees are excelling and areas in which they need additional training. (Principle 4)

H. Town Council could support the evaluation system by indicating it would be relied upon in determining additional benefits and disciplinary measures for the future. (Principle 4 and 5)

Component Two: Risk Assessment

A. After the Clerk-Treasurer assigns the specific duties in the receipt process, she could determine the likelihood that an employee would make an error or misappropriate funds while completing their duty. (Principle 6)

B. She could have consulted with the Town Council to identify the risky areas and they could determine the mitigating procedures that they would institute to lessen the risk of theft or error. (Principle 7)

C. The risks could include an employee manipulating the computer system resulting in theft (Principle 8). Receipts not posted correctly or not posted at all could create financial reports that don't give an accurate account of the fund activities and balances, therefore proper decisions may not be made. (Principle 8)

D. The Clerk-Treasurer and Town Council could develop contingency plans for situations in which the make-up and environment of the Town changes significantly. For example, if the Utility Clerk position is vacant for a number of months, then the Clerk-Treasurer could establish some additional mitigating controls involving the Town Council to ensure the internal control system continues to function. (Principle 9)

Component Three: Control Activities

As much as possible the procedures to collect, verify, deposit, and post payments need to be segregated among all employees of the Town. Any reviews performed could be documented by the reviewer initialing the receipt/report/deposit being verified.

A. The Clerk-Treasurer with approval of the Town Council could formalize the procedures below by officially adopting similar procedures as below. (Principle 12)

Case Studies

B. The Utility Clerk could be responsible for collecting payments from customers and issuing receipts. The Utility Clerk counts the drawer to determine total amount collected for the day. (Principles 10 & 11)

C. The Deputy Clerk-Treasurer reconciles the End of Day Collections report to the cash drawer and completes the deposit ticket. She could also make any corrections/adjustments requested to customer accounts. (Principles 10 & 11)

D. The Clerk-Treasurer reviews the receipt postings to the customer accounts, verifies the deposit to the deposit ticket and makes the deposit at the bank. She could also review all adjustments to customer accounts. (Principles 10 & 11)

E. The computer accounting system will restrict users from performing tasks that they are not assigned. The system could limit the ability of certain users to record voids or adjustments to individual's accounts. The system could date and time stamp reports used to reconcile collections to deposits. (Principles 10 & 11)

F. The Town Council could review reports that compared billings to collections that could indicate if unexpected postings were being made. They could also compare collection reports to bank statement deposits to assess if collections are being deposited. (Principles 10 & 11)

Component Four: Information and Communication

A. The Clerk-Treasurer could document and share with the employees and Town Council the tasks that are assigned to each employee. (Principle 14)

B. She could encourage everyone to evaluate the procedures that she assigns and provide information that could make the internal controls more effective. (Principle 14)

C. She could determine the supporting documents and reports that are needed to provide an evaluation that the payments received have been posted and deposited. (Principle 13)

D. The Town Council could inquire/ensure that all employees are performing their assigned tasks. The Clerk-Treasurer could provide notification, through signage, that all customers making a payment would receive a receipt and customer payment histories would be available upon request. (Principle 15)

Case Studies

Component Five: Monitoring

- A. The Clerk-Treasurer could do random checks of a day's cash collections to what was counted by the Utility Clerk and verified by the Deputy-Clerk Treasurer. (Principle 16)
- B. She could look for areas in which the internal control procedures were not followed. (Principle 17)
- C. The Town Council could randomly request to review collection reports and bank reconciliations to determine if the information that they are being provided is reliable. (Principle 16)
- D. The Clerk-Treasurer and the Town Council could periodically meet to evaluate the internal control procedures that have been put in place to determine if they need to be updated for controls that are ineffective. (Principle 17)
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CASE STUDY – CREDIT CARDS

Background

The fiscal officer of a political subdivision used numerous credit cards issued in the name of the political subdivision for unauthorized personal purchases in the amount of \$346,156. The purchases, which spanned a period of six years, included personal items such as food, alcohol, gift cards, toys, grocery, clothing, jewelry, sales tax, batteries, and other miscellaneous merchandise.

Audit Results

1. The political subdivision did not have a formal policy governing the use of credit cards.
2. Payments were not supported by a claim and were not approved by the legislative body.
3. Credit card purchases were not supported by documentation, such as receipts or invoices.
4. Incompatible activities related to disbursements were not separated.

Case Studies

Possible Controls

**Component One:
Control Environment**

The oversight body and management set the tone of the organization, which directly influences the effectiveness of internal controls within the government. In this case, the political subdivision did not have a formal policy governing the use of credit cards. Suggested procedures related to credit card usage:

A. The oversight body and management demonstrate a commitment to integrity and ethical values by stressing adherence to statutory provisions regarding the payment of claims, the prescribed accounting system, and uniform compliance guidelines published by the State Board of Accounts. (Principle 1)

B. The oversight body adopts a credit card policy with the minimum requirements set forth in the State Board of Accounts uniform compliance guidelines. (Principle 2)

C. Management emphasizes organizational structure and specifically assigns responsibilities not otherwise delegated by statute, for example individuals responsible for maintaining custody of the cards, reviewing claims for sufficient documentation, and reconciling the credit card statement to approved claims. (Principle 3)

D. Employees involved in the credit card process are trained and educated on proper usage, accountability, adherence to the credit card policies, and compliance with state statutes. (Principle 4)

E. During the claim approval process, the oversight body and management evaluate the credit card claims for adherence to the policy. In the Credit Card Policy, management considers the consequences for failure to follow required procedures; for example, the consequences and responsibility for late charges, insufficient documentation, or personal use. (Principle 5)

Case Studies

Component Two: Risk Assessment

Management should define objectives to identify risks and then develop procedures to mitigate the risk. In this case, management had no policies or procedures in place to limit the use of the credit cards, detect fraud, or reduce non-fraud risk associated with credit card usage. If management had defined objectives and identified risks, they would have developed controls to mitigate those risks. Suggested procedures include the following:

A. Example objectives

Operations Objective: All credit card charges must be for a business purpose, be supported by appropriate documentation, and submitted in a timely manner.

In order to accomplish this objective, management defines acceptable business uses, supporting documentation, and timely submission and designates a person responsible for ensuring compliance with the policy. Ideally this person does not have credit card purchasing authority.

Reporting Objective: All credit card charges must be accurately reported in the financial statements.

In order to accomplish this objective, management requires a procedure comparing bank statement disbursements to approved claims.

Compliance Objective: Credit card claims must meet the requirements of IC 5-11-10 and be on a form prescribed by the State Board of Accounts.

In order to accomplish this objective, management reviews claims individually for supporting documentation, rather than just signing the Accounts Payable Voucher. (Principle 6)

B. Management identifies risk, analyzes risk, and develops procedures to mitigate risks associated with credit card usage. Examples of risk, other than fraud risk, are as follows:

- Non-compliance with statutes.
- Insufficient Documentation.

Case Studies

- Interest and Finance Charges.
- Unnecessary expenses.
- Insufficient appropriation.
- Lost or stolen cards.
- Noncompliance with other policies or ordinances. (Principle 7)

C. Management mitigates risk through the adoption of the Uniform Compliance Guidelines related to credit cards, as follows:

1. The governing board must authorize credit card use through an ordinance or resolution, which has been approved in the minutes.
2. Issuance and use should be handled by an official or employee designated by the board.
3. The purposes for which the credit card may be used must be specifically stated in the ordinance or resolution.
4. When the purpose for which the credit card has been issued has been accomplished, the card should be returned to the custody of the responsible person.
5. The designated responsible official or employee should maintain an accounting system or log which would include the names of individuals requesting usage of the cards, their position, estimated amounts to be charged, fund and account numbers to be charged, date the card is issued and returned, etc.
6. Credit cards should not be used to bypass the accounting system. One reason that purchase orders are issued is to provide the fiscal officer with the means to encumber and track appropriations to provide the governing board and other officials with timely and accurate accounting information and monitoring of the accounting system.

Case Studies

7. Payment should not be made on the basis of the statement or a credit card slip only. Procedures for payments should be no different than for any other claim. Supporting documents such as paid bills and receipts must be available. Additionally, any interest or penalty incurred due to the late filing or furnishing of documentation by an officer or employee should be the responsibility of that officer or employee. (Principle 7)

D. Management considers the types of fraud which can occur with credit card usage, including, but not limited to fraudulent financial reporting and misappropriation of assets. In addition to fraud, management weighs the likelihood of other types of misconduct such as waste or abuse. Considerations which may reduce the potential for fraud include the following:

1. The number of cards needed. In this case, an extraordinarily large number of credit cards were issued to the unit.
2. Designation of authorized users; documentation that authorized users have agreed to the terms of the credit card policy, statutory provisions, and the prescribed accounting system.
3. Written direction on the purposes or circumstances for which the cards may be used, including appropriate purchases and/or appropriate vendors.
4. Restrictions placed on the cards to reduce or mitigate the risks, such as a reasonable credit limit, deactivation of cash advancement features, limitation on the purchase amount per transaction, etc. (Principle 8)

E. In responding to risk, management reviews the official duties of all employees and purchase adequate bond coverage at amounts equal to or above the minimum amount required by statute.

In response to fraud or variances, management must comply with certain reporting statutes:

- IC 5-11-1-27(l) Report of Misappropriation of Funds to State Board of Accounts and Prosecuting Attorney.

Case Studies

- IC 5-11-1-27(j) Report of Material Variances, Losses, Shortages, or Thefts to the State Board of Accounts. (Principle 8)

F. The internal controls and policies related to credit card usage must be evaluated and adjusted on a regular basis for personnel changes, newly elected officials, financial fluctuations, etc. (Principle 9)

Component Three: Control Activities

In this case, control activities were not sufficient to detect fraudulent use of credit cards; incompatible activities were not separated. In addition to the policies and procedures outlined in the Control Environment and Risk Assessment section, management may consider the following suggested procedures.

A. Management assigns a person, other than the official custodian of the credit cards or fiscal officer, to match invoices to charges on the credit card statements and analyze the use of the credit card against adopted policy. In this case, the designee would have noticed that certain charges were not supported by invoices or not related to a business purpose. (Principle 10)

B. Management assigns a person, other than the official custodian of the credit cards or fiscal officer, to reconcile the credit card statement to credit card claims approved by the legislative body. In this case, the designee would have noticed that the total dollar amount paid on the credit card statement was more than the claim approved by the legislative body. (Principle 10)

C. Management assigns a person the responsibility to reconcile disbursements per the bank statement to approved claims. In this case, the designee would have noticed that the total dollar disbursements to credit card vendors were more than the claims approved by the legislative body. (Principle 10)

Component Four: Information and Communication

Management should receive quality information from internal and external sources regarding credit card usage. If management had reviewed credit card statements and bank statements along with the claims presented for approval, they would have been able to detect additional charges not submitted for approval. (Principle 13)

Case Studies

Component Five: Monitoring

A designated person, such as an office holder or department head, periodically reviews the completion of designated policies and procedures, such as control activities and determines if controls are being used as designed. Suggested monitoring procedures include:

A. An office holder or department head periodically reviews the analysis of sufficient documentation and appropriate expenses for credit card transactions. (Principle 16)

B. An office holder or department head periodically reviews the reconciliation of the credit card statement to the approved claims related to credit card transactions. (Principle 16)

C. An office holder or department head periodically reviews the reconciliation of bank statement disbursement to approved claims. (Principle 16)

D. Violations of policies and procedures are noted and evaluated. (Principle 17)

CONCLUSION

In this case, the governmental unit lacked policies and procedures related to the five components and seventeen principles of internal control. An effective system of internal control could have detected the fraud sooner, resulting in a much smaller loss to the taxpayers.

APPENDIX

**INTERNAL CONTROL TRAINING CERTIFICATION
FOR ELECTED OFFICIALS, APPOINTEES, AND EMPLOYEES**

I, _____, the duly elected, appointed, or employed
(print name)

_____ for _____ certify that I
(position or title) (political subdivision)

received the following training concerning internal controls standards and procedures as required
by Ind. Code § 5-11-1-27(g)(2):

Title of Training	Time Spent
_____	_____
_____	_____
_____	_____

Date: _____

Signature

* This certification may be printed, signed, and retained in paper form or electronically. If signed electronically, the elected official, appointee, or employee must designate his or her signature by typing the last four (4) digits of their Social Security number in the signature line.

4. Internal control training materials

Indiana Code § 5-11-1-27(f) states:

Not later than November 1, 2015, the state board of accounts shall develop or designate approved personnel training materials as approved by the audit committee, to implement this section.

The State Board of Accounts has developed the following training materials on internal controls:

1. *Uniform Internal Control Standards for Indiana Political Subdivisions* manual by the State Board of Accounts.
2. Numerous webinars containing the phrase “internal control” posted on the SBOA’s website.
3. Live presentations by the SBOA at annual called meetings and conferences around the state.

The State Board of Accounts has designated the following training materials on internal controls:

4. *Internal Control – Integrated Framework* (2013) by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).
5. Guidance papers, principals, or frameworks on Governance and Operational Performance, Internal Controls, Enterprise Risk Management, or Fraud Deterrence by COSO.
6. *Standards for Internal Control in the Federal Government* (the “Green Book”) by the Comptroller General of the United States.

In addition, the State Board of Accounts recognizes that political subdivisions may find appropriate internal control training materials on their own initiative. So, the following training materials may be designated:

7. Materials identified and submitted by political subdivisions, which are approved by the SBOA and/or posted on the SBOA’s website.

**COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR)
FOR THE STATE OF INDIANA**

1. Summary of fiscal year 2014 CAFR
2. Summary of fiscal year 2014 Supplement Audit of Federal Awards.
3. Status of fiscal year 2015 CAFR.
4. Status of fiscal year 2015 Supplement Audit of Federal Awards.
5. Findings for fiscal year 2014 CAFR and Supplement Audit of Federal Awards are attached for your review. Fiscal year 2014 CAFR and Supplement Audit of Federal Awards is available in its entirety at <http://www.in.gov/sboa/WebReports/B44954.pdf>.

Summary of FY 2014 CAFR

- The State Board of Accounts' CAFR Opinion was provided on December 30, 2014.
- The Opinion on the CAFR was unmodified indicating that the State's financial statements presented fairly, in all material respects, the financial position of the State.
- The Auditor of State received the GFOA certificate for excellence in financial reporting for the FY 2014 CAFR.
- The State Board of Accounts attributed a total 5,500 hours to the FY 14 CAFR audit.
- The State Board of Accounts reported five internal control findings related to the financial statements. The findings are including in your handout and are findings 2015-001 through 2015-005.

Summary of Findings

Finding No.	Title
2014-001	Internal Control Over Tax Revenues
2014-002	Infrastructure Reporting
2014-003	Pension Reporting
2014-004	FSSA Accounts Receivable Reporting
2014-005	Accounts Receivable and Accounts Payable Reporting - Unemployment Insurance

Summary of FY 2014 Supplemental Audit of Federal Awards

- The State Board of Accounts provided its opinion on the supplemental audit of federal awards on March 24, 2015.
- The State Board of Accounts attributed 11,752 hours to the audit of the federal awards.
- The State Board of Accounts audited 13 major programs for FY 2014 supplemental audit of Federal Awards.

Federal Programs Audited in FY 2014

CFDA No.	Title	Agencies
14.228	Community Development Block Grants	Lieutenant Governor's Office
17.225	Unemployment Insurance	Department of Workforce Development
20.205	Highway Planning and Construction	Department of Transportation
10.553, 555, 556, 559	Child Nutrition Cluster	Department of Education
10.558	Child and Adult Care Program	Department of Education
84.377, 388	School Improvement Grants	Department of Education
93.778	Medical Assistance Program	Family and Social Services Administration
93.767	Children's Health Insurance Program	Family and Social Services Administration
96.001	Social Security – Disability Insurance and Supplemental Income	Family and Social Services Administration
93.558	Temporary Assistance to Needy Families (TANF)	Family and Social Services Administration and Department of Child Services
93.563	Child Support Enforcement	Department of Child Services
93.658	Foster Care	Department of Child Services
93.659	Adoption Assistance	Department of Child Services

- The State Board of Accounts reported 26 federal findings in the FY 2014 Supplemental Audit of Federal Awards, which are included in your handout and summarized by type and major program below:

Findings By Type

Internal Control, Non Compliance, Qualified	5
Internal Control, Non Compliance, Not Qualified	9
Non Compliance Only	1
<u>Internal Control Only</u>	<u>11</u>
Total Major Program Findings:	26

Findings By Major Program

14.228 – Community Development Block Grants - Findings

Finding #	Requirement	Internal Control Non Compliance Qualified	Internal Control Non Compliance Not Qualified	Non Compliance Only Not Qualified	Internal Control Only Not Qualified
2014-006	Cash Management	X			
2014-007	Reporting				X
2014-008	Subrecipient Monitoring				X

17.225 – Unemployment Insurance

Finding #	Requirement	Internal Control Non Compliance Qualified	Internal Control Non Compliance Not Qualified	Non Compliance Only Not Qualified	Internal Control Only Not Qualified
2014-009	Special Tests and Provisions				X
2014-010	Special Tests and Provisions				X
2014-011	Special Tests and Provisions			X	

20.205 – Highway Planning and Construction

Finding #	Requirement	Internal Control Non Compliance Qualified	Internal Control Non Compliance Not Qualified	Non Compliance Only Not Qualified	Internal Control Only Not Qualified
2014-012	Cash Management		X		
2014-013	Reporting		X		
2014-014	Davis Bacon	X			
2014-015	Special Tests and Provisions				X
2014-016	Subrecipient Monitoring	X			
2014-017	Special Tests and Provisions				X

84.387 and 84.388 – School Improvement Cluster

Finding #	Requirement	Internal Control Non Compliance Qualified	Internal Control Non Compliance Not Qualified	Non Compliance Only Not Qualified	Internal Control Only Not Qualified
2014-018	Suspension and Debarment		X		
2014-019	Eligibility, Earmarking, Reporting				X
2014-020	Subrecipient Monitoring		X		

Child Nutrition Cluster and 10.558 – Child Adult Care Program

Finding #	Requirement	Internal Control Non Compliance Qualified	Internal Control Non Compliance Not Qualified	Non Compliance Only Not Qualified	Internal Control Only Not Qualified
2014-021	Reporting		X		

10.558 - Child and Adult Care Program

Finding #	Requirement	Internal Control Non Compliance Qualified	Internal Control Non Compliance Not Qualified	Non Compliance Only Not Qualified	Internal Control Only Not Qualified
2014-022	Eligibility				X

**93.778 – Medical Assistance Program and
93.676 – Children’s Health Insurance Program**

Finding #	Requirement	Internal Control Non Compliance Qualified	Internal Control Non Compliance Not Qualified	Non Compliance Only Not Qualified	Internal Control Only Not Qualified
2014-023	Activities Allowed/Allowable Costs and Reporting				X

96.001 - Social Security – Disability Insurance and Supplemental Income

Finding #	Requirement	Internal Control Non Compliance Qualified	Internal Control Non Compliance Not Qualified	Non Compliance Only Not Qualified	Internal Control Only Not Qualified
2014-024	Reporting		X		

93.558 – Temporary Assistance for Needy Families

Finding #	Requirement	Internal Control Non Compliance Qualified	Internal Control Non Compliance Not Qualified	Non Compliance Only Not Qualified	Internal Control Only Not Qualified
2014-025	Activities Allowed/Allowable Costs and Eligibility (FSSA)		X		
2014-026	Activities Allowed/Allowable Costs and Eligibility (DCS)				X

**93.563 – Child Support
93.658 – Foster Care
93.659 – Adoption Assistance**

Finding #	Requirement	Internal Control Non Compliance Qualified	Internal Control Non Compliance Not Qualified	Non Compliance Only Not Qualified	Internal Control Only Not Qualified
2014-027	Cash Management and Period of Availability				X

93.563 – Child Support

Finding #	Requirement	Internal Control Non Compliance Qualified	Internal Control Non Compliance Not Qualified	Non Compliance Only Not Qualified	Internal Control Only Not Qualified
2014-028	Reporting		X		
2014-029	Subrecipient Monitoring	X			
2014-030	Cash Management		X		

93.659 – Adoption Assistance

Finding #	Requirement	Internal Control Non Compliance Qualified	Internal Control Non Compliance Not Qualified	Non Compliance Only Not Qualified	Internal Control Only Not Qualified
2014-031	Activities Allowed, Allowable Costs, Eligibility	X			

Status of FY 2015 CAFR and Supplemental Audit of Federal Awards

I. CAFR

- There are 10 field examiners currently working on the audit of the FY 2015 CAFR.
- There are 5,820 Assigned Hours for the audit of the FY 2015 CAFR. As of September 30, 2015, the State Board of Accounts has attributed 2,038 hours to the audit of the FY 2015 CAFR, which is approximately 35% of the total hours.
- The State Board of Accounts' audit opinion for the 2015 CAFR will be provided no later than December 31, 2015.
- At this time, the State Board of Accounts has not concluded any possible findings for the FY 2015 financial audit of the State's CAFR.

II. SUPPLEMENTAL AUDIT OF FEDERAL AWARDS

- The State Board of Accounts will be auditing 19 major programs for the FY 2015 supplemental audit of federal awards.
- The State Board of Accounts has started the audit of 17 of those 19 major programs.
- There are 18 field examiners dedicated to the audit of federal awards.
- The State Board of Accounts' opinion and findings for the FY 2015 supplemental audit of federal awards will be filed no later than March 31, 2016.
- As of the date of this report, the State Board of Accounts has not concluded any possible findings for the FY 2015 supplemental audit of federal awards.
- Below is a summary of the federal programs the State Board of Accounts auditing, the amount of time assigned to each program, and the amount of time attributed to the audit as of September 30, 2015.

Status of FY 2015 Supplemental Audit of Federal Awards

FEDERAL PROGRAM/AREA	Started	<u>Hours Assigned</u>	<u>Time Attributed Through 9-30-15</u>	<u>Percent Complete</u>
FSSA MEDICAID CLUSTER	Yes	1,875.00	229	12.21%
DWD UNEMPLOYMENT INSURANCE (17.225)	Yes	750.00	5	0.60%
INDOT HWY PLANNING/CONSTRUCTION CLUSTER	Yes	1,500.00	396	26.40%
DOE CHILD NUTRITION CLUSTER	Yes	412.50	8	1.94%
FSSA STATE CHILDREN'S INSURANCE PROGRAM		750.00	-	0.00%
FSSA TANF CLUSTER	Yes	937.50	26	2.77%
DCS CHILD SUPPORT ENFORCEMENT (93.563)	Yes	412.50	7	1.70%
DCS FOSTER CARE TITLE IV-E (93.658)	Yes	337.50	81	24.00%
LT GOV STATE ADMINISTERED CDBG CLUSTER	Yes	337.50	180	53.33%
DCS ADOPTION ASSISTANCE	Yes	412.50	71	17.21%
DISABILITY INSURANCE/SSI CLUSTER		337.50	-	0.00%
SCHOOL IMPROVEMENT CLUSTER	Yes	412.50	40	9.70%
CHILD AND ADULT CARE FOOD PROGRAM	Yes	337.50	12	3.56%
TITLE I GRANTS TO LEA (84.010)	Yes	337.50	42	12.44%
IMPROVING TEACHER QUALITY (84.367)	Yes	337.50	60	17.78%
WIA ADULT PROGRAM (17.258)	Yes	750.00	225	30.00%
CHILD CARE AND DEVELOPMENT BLOCK GRANT	Yes	750.00	15	2.00%
VOC REHAB GRANTS TO STATES (84.126)	Yes	600.00	246	41.00%
PREV TREATMENT SUBSTANCE ABUSE (93.959)	Yes	<u>412.50</u>	<u>30</u>	<u>7.27%</u>
		<u>13,987.50</u>	<u>2,257</u>	<u>16.13%</u>

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Section I - Summary of Auditor's Results

Financial Statement:

Type of auditor's report issued:	Unmodified
Internal control over financial reporting:	
Material weaknesses identified?	yes
Significant deficiencies identified?	yes
Noncompliance material to financial statement noted?	yes

Federal Awards:

Internal control over major programs:	
Material weaknesses identified?	yes
Significant deficiencies identified?	none reported
Type of auditor's report issued on compliance for major programs:	Unmodified for all programs except CDBG - State-Administered CDBG Cluster, Highway Planning and Construction Cluster, Child Support Enforcement, and Adoption Assistance - Title IV-E, which were Qualified.

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133?	yes
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Identification of Major Programs:

CFDA Number	Name of Federal Program or Cluster
10.558	Child Nutrition Cluster Child and Adult Care Food Program CDBG - State-Administered CDBG Cluster
17.225	Unemployment Insurance Highway Planning and Construction Cluster School Improvement Grants Cluster
93.563	Child Support Enforcement TANF Cluster Medicaid Cluster
93.658	Foster Care - Title IV-E
93.659	Adoption Assistance - Title IV-E
93.767	Children's Health Insurance Program Disability Insurance/SSI Cluster

Dollar threshold used to distinguish between Type A and Type B programs: \$30,000,000

Auditee qualified as low-risk auditee?	no
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STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

Section II - Financial Statement Findings

FINDING 2014-001 - INTERNAL CONTROLS OVER TAX REVENUES

The Indiana Department of Revenue (DOR) has stand-alone custom taxpayer account systems, spreadsheets and databases that were developed over time to support the core tax processes at the DOR. The DOR's Returns Processing System (RPS) processes the majority of tax returns collected, refunds issued, and adjustments to taxpayer accounts, but other stand-alone taxpayer account systems and databases are used by the DOR to support tax types not maintained in the RPS. The DOR posts tax revenue receipts to the State of Indiana's (State) ENCOMPASS financial accounting system based upon bank reports and other related deposit receipt information. At the time of posting the receipts to ENCOMPASS, the DOR performs daily reconciliations between the RPS, the bank and ENCOMPASS for EFT deposits; however, the DOR did not consistently perform reconciliations between the taxpayer account systems and ENCOMPASS to ensure that all tax revenue transactions, including refunds and adjustments subsequently posted to taxpayer accounts, were also properly posted to ENCOMPASS. Due to the lack of reconciliations, the following variances were identified:

- When comparing the total of the detail of transactions provided as support from DOR's taxpayer account systems to ENCOMPASS for General fund tax types tested, net revenue activity presented in ENCOMPASS was \$51,977,067 greater than the total of the detail of transactions. Conversely, for Non-Major Governmental Funds tax revenues tested, net revenue activity presented in ENCOMPASS was \$271,003 less than the total of the detail of transactions. The DOR was unable to present additional transactions or provide additional information to account for these differences. However, these variances equated to less than 1 percent of the overall revenue activity tested. These variances were not considered material to the financial statements.
- As a result of our testing of General fund tax revenue transactions, we identified specific variances between the transaction files and ENCOMPASS. Based on our audit procedures, we projected a variance of \$29,924,014. This projected variance identified more activity reported in ENCOMPASS than was provided in the aforementioned detailed transactions. The DOR was unable to present additional transactions or provide additional information to account for this difference. This projected variance, alone or in combination with the variance noted above, was not considered material to the financial statements.

Additionally, the State issues tax refunds by high volume warrant and direct deposit, which are posted as a refund of tax revenues to ENCOMPASS. Tax refunds issued by high volume warrant are posted from the RPS to ENCOMPASS through an automated process. Although the DOR has controls in place to reduce the risk of improper release of tax refunds, adequate controls were not in place to ensure that tax refunds issued by high volume warrant were properly classified by tax type when posted to ENCOMPASS.

Controls over the receipting, disbursing, recording, and accounting for the financial activities are necessary to avoid substantial risk of invalid transactions, inaccurate records and financial statements, and incorrect decision making. An Agency's control environment consists of the overall attitude, awareness and actions of management and the governing board or commission. This would include establishing and monitoring policies for developing and modifying accounting systems and control procedures. (Accounting and Uniform Compliance Guidelines Manual for State and Quasi Agencies, Organizational Overview Chapter)

System controls are in effect on the ENCOMPASS financial accounting system, which is the official book of record for the State; however, each agency is responsible for controls in any subsidiary systems used or other records maintained. At all times, the agency's manual and subsidiary ledgers should reconcile with ENCOMPASS. (Accounting and Uniform Compliance Guidelines Manual for State and Quasi Agencies, Organizational Overview Chapter)

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

The computerized accounting system must maintain electronic audit trails sufficient to trace all transactions from the original source of entry into the system, through all system processing, through various levels of summarizations, and to the results produced by the system. The audit trails must also maintain sufficient information to trace all transactions from the final results produced by the system, through all system processing and summarizations, and to the original source of entry into the system. Audit trails must also identify the user that processed the transaction or updated the information. These audit trails must be protected from modification and deletion. (Accounting and Uniform Compliance Guidelines Manual for State and Quasi Agencies, 14.3.5)

FINDING 2014-002 - INFRASTRUCTURE REPORTING

The Indiana Department of Transportation (INDOT) provides Infrastructure Fixed Asset Inventory reports for inclusion in the compilation of the Statement of Net Position, capital asset disclosures in the Notes to the Financial Statements, and Required Supplementary Information. Controls in place did not detect errors in the capital asset disclosures, included in the Notes to the Financial Statements, presented for audit. The following classification and reporting errors were identified:

1. Our testing identified one project reported as complete that should have still been reported as Construction in Progress (CIP), resulting in an error of \$1.3 million. This error, when projected, would equate to a \$61,668,855 overstatement of Infrastructure and understatement of CIP.
2. Our testing identified that a project reporting \$1.5 million of CIP additions was already completed and should not have been included in CIP. This error, when projected, would equate to a \$73,125,242 overstatement of CIP additions and understatement of Infrastructure.
3. INDOT review procedures failed to identify duplicate invoices in the Condemned and Secured land parcels compiled to calculate the reduction of Right of Way (ROW) CIP. This caused an understatement of ROW CIP and an overstatement of ROW Land of \$3,594,691.
4. INDOT staff appropriately identified that the Infrastructure CIP beginning balance needed to be reduced; however, the reduction of the balance was not reported accurately within the Notes to the Financial Statements. Approximately \$104 million in retired Infrastructure CIP should not have been classified as a retirement of CIP, but instead should have been a prior period adjustment reducing the beginning CIP balance.

Following our communication of the above noted errors, adjustments were recorded to correct the financial statements.

Controls over the receipting, disbursing, recording, and accounting for the financial activities are necessary to avoid substantial risk of invalid transactions, inaccurate records and financial statements, and incorrect decision making. An Agency's control environment consists of the overall attitude, awareness and actions of management and the governing board or commission. This would include establishing and monitoring policies for developing and modifying accounting systems and control procedures. (Accounting and Uniform Compliance Guidelines Manual for State and Quasi Agencies, Organizational Overview Chapter)

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

FINDING 2014-003 - PENSION REPORTING

The State of Indiana (State) Comprehensive Annual Financial Report (CAFR) provided for audit did not include the required disclosures and Required Supplementary Information (RSI) for the State Police Pension Fund in accordance with Governmental Accounting Standards Board (GASB) Statement 67. The information excluded from the Notes to the Financial Statements consisted of annual money-weighted rate of return (1 year), components of net pension liability and net position as a percentage of Total Pension Liability (TPL) (1 year), and assumptions used to measure TPL. Excluded information from the RSI consisted of the Schedule of Changes in Net Pension Liability and Related Ratios, Schedule of Contributions, and Schedule of Investment Returns. Controls in place did not detect this omission prior to providing the statements for audit. Following our communication of this omission, the State subsequently corrected and included the required disclosures and the RSI.

Controls over the receipting, disbursing, recording, and accounting for the financial activities are necessary to avoid substantial risk of invalid transactions, inaccurate records and financial statements, and incorrect decision making. An Agency's control environment consists of the overall attitude, awareness and actions of management and the governing board or commission. This would include establishing and monitoring policies for developing and modifying accounting systems and control procedures. (Accounting and Uniform Compliance Guidelines Manual for State and Quasi Agencies, Organizational Overview Chapter)

FINDING 2014-004 - FSSA ACCOUNTS RECEIVABLE REPORTING

The State of Indiana (State) Comprehensive Annual Financial Report (CAFR) provided for audit contained an overstatement of Accounts Receivable and Revenue totaling \$51 million in Non-Major Governmental Funds. Controls in place did not detect this error prior to providing the statements for audit.

The Family and Social Services Administration transferred the records of benefit overpayments from a subsidiary system to the State's ENCOMPASS financial accounting system in fiscal year 2014. A total of \$51 million in recoupments due from these transferred records was recorded as an increase to accounts receivable and revenue. The benefit overpayments were from the Supplemental Nutrition Assistance Program (SNAP), Temporary Assistance to Needy Families (TANF), and Medicaid programs. Once recovered, all but a small percentage of the recoupments must be returned to the federal government. Additionally, in any given year, only an estimated 1 percent of the total is considered recoverable. Since only a small percentage of the funds are recoverable every year and funds recovered do not ultimately belong to the State, this total is neither an asset of, nor revenue to, the State. Following our communication of this error, the State of Indiana recorded adjustments to correct accounts receivable and revenue totals in the financial statements.

Controls over the receipting, disbursing, recording, and accounting for the financial activities are necessary to avoid substantial risk of invalid transactions, inaccurate records and financial statements, and incorrect decision making. An Agency's control environment consists of the overall attitude, awareness and actions of management and the governing board or commission. This would include establishing and monitoring policies for developing and modifying accounting systems and control procedures. (Accounting and Uniform Compliance Guidelines Manual for State and Quasi Agencies, Organizational Overview Chapter)

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

FINDING 2014-005 - ACCOUNTS RECEIVABLE AND ACCOUNTS PAYABLE REPORTING - UNEMPLOYMENT INSURANCE

The Indiana Department of Workforce Development (DWD) provides Unemployment Compensation Insurance Fund (UI Fund) financial statements for inclusion as a major enterprise fund in the Comprehensive Annual Financial Report (CAFR). Both the accounts receivable and accounts payable totals in the UI Fund financial statements presented for audit were understated by material amounts. Controls in place did not detect these errors prior to providing the statements for audit.

The accounts receivable total on the UI Fund statements represents delinquent Unemployment Insurance taxes owed by employers. The total accounts receivable presented for audit (\$23.6 million) included delinquent employer taxes up to 15 months old. The DWD's policy on the collectability of delinquent taxes includes debt greater than 15 months old. Accounts receivable, after recalculation of delinquent UI Fund taxes using the parameters of collectability set by the DWD management, was \$83.9 million. The UI Fund accounts receivable total presented for audit was understated by \$60.3 million.

The accounts payable total on the UI Fund statements presented for audit (\$3.3 million) represented benefit and other benefit related claims due, but not paid as of June 30, 2014. This total did not include employer tax overpayments held by the DWD. Employers that overpay UI taxes can leave the balance with the DWD to offset future taxes owed, or can request a refund. Overpayments over four years old are not refundable per Indiana Code 22-4-32-19. The balance of employer tax overpayments under four years of age is a liability of the State of Indiana. Total overpayments held by the DWD, for less than four years as of June 30, 2014, totaled \$18.5 million. The UI Fund accounts payable presented for audit was understated by \$18.5 million.

Following our communication of the above noted errors, adjustments were recorded to correct the financial statements.

Controls over the receipting, disbursing, recording, and accounting for the financial activities are necessary to avoid substantial risk of invalid transactions, inaccurate records and financial statements, and incorrect decision making. An Agency's control environment consists of the overall attitude, awareness and actions of management and the governing board or commission. This would include establishing and monitoring policies for developing and modifying accounting systems and control procedures. (Accounting and Uniform Compliance Guidelines Manual for State and Quasi Agencies, Organizational Overview Chapter)

Section III - Federal Award Findings and Questioned Costs

FINDING 2014-006 - CASH MANAGEMENT

Federal Agency: U.S. Department of Housing and Urban Development
Federal Program: Community Development Block Grants/State's Program
and Non-Entitlement Grants in Hawaii

CFDA Number: 14.228

Federal Award Number and Year (or Other Identifying Number): B-05-DC-180001, B-06-DC-18-0001, B-07-DC-18-0001, B-08-DC-18-0001, B-08-DF-18-0001, B-08-DI-18-0001, B-09-DC-18-0001, B-10-DC-18-0001, B-11-DC-18-0001, B-12-DC-18-0001, B-13-DC-18-0001, and B-08-DI-18-0001

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

Management of the Indiana Office of Community and Rural Affairs (OCRA) has not established an effective internal control system over the Cash Management compliance requirement. Controls were not in place to ensure the time elapsing between the transfer of federal funds and the disbursement of those funds by the State of Indiana (State) was minimized. The failure to establish an effective control resulted in non-compliance with the Cash Management compliance requirement.

The Community Development Block Grant (CDBG) was listed as a major federal assistance program in the Cash Management Improvement Act (CMIA) Agreement in effect during this audit period. The CMIA Agreement listed an Average Clearance funding technique, with average days of clearance of 8 days for CDBG. Additionally, the CMIA Agreement showed a receipt window of 2 days for HUD ACH transfers. Of the federal draws tested, eleven of twenty-one were requested between 8 and 54 days prior to payment by the State. Six of the twenty-one tested were requested between 0 and 4 days after payment by the State. The Average Clearance days for the audit period were recalculated by the OCRA's management. This new calculation was presented to us and we determined the Average Clearance days in the CMIA agreement were incorrect. The true Average Clearance for the audit period was 0 days.

24 CFR part 85.21(b) states in part:

"Methods and procedures for payment shall minimize the time elapsing between the transfer of funds and disbursement by the grantee or subgrantee, in accordance with Treasury regulations at 31 CFR part 205."

31 CFR part 205.1 states in part:

"(a) This part prescribes rules for transferring funds between the Federal government and States for Federal assistance programs. This part applies to:

- (1) All States as defined in §205.2; and
- (2) All Federal program agencies, except the Tennessee Valley Authority (TVA) and its Federal assistance programs.

(b) Only programs listed in the Catalog of Federal Domestic Assistance, as established by Chapter 61 of Title 31, United States Code (U.S.C) are covered by this part."

31 CFR part 205.22(a) states in part:

"If a State has knowledge, at any time, that a clearance pattern no longer reflects a Federal assistance program's actual clearance activity, or if a Federal assistance program undergoes operational changes that may affect clearance activity, the State must notify us, develop a new clearance pattern, and certify that the new pattern corresponds to the Federal assistance program's clearance activity. Clearance patterns will remain in effect until a new clearance pattern is certified."

OMB Circular A-133, Subpart C, section .300 states in part:

"The auditee shall: . . . (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs."

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

Failure to comply with the requirements may cause future funding to be reduced by the U.S. Department of Housing and Urban Development.

We recommended that the OCRA's management develop and implement procedures and controls to ensure that the time between the receipt and disbursement of federal funds is in agreement with the CMIA Agreement.

FINDING 2014-007 - REPORTING

Federal Agency: U.S. Department of Housing and Urban Development
Federal Program: Community Development Block Grants/State's Program
and Non-Entitlement Grants in Hawaii

CFDA Number: 14.228

Federal Award Number and Year (or Other Identifying Number): B-05-DC-180001, B-06-DC-18-0001,
B-07-DC-18-0001, B-08-DC-18-0001,
B-08-DF-18-0001, B-08-DI-18-0001,
B-09-DC-18-0001, B-10-DC-18-0001,
B-11-DC-18-0001, B-12-DC-18-0001,
B-13-DC-18-0001, and B-08-DI-18-0001

Management of the Indiana Office of Community and Rural Affairs (OCRA) did not have documentation to support their internal control system over the Reporting compliance requirement. The OCRA's procedure was to review the Performance and Evaluation Report (PER) and provide verbal approval of the report prior to submission. Based on the procedure in place, we were unable to obtain documentation that would allow us to determine if the control had been properly implemented or that it was operating effectively.

OMB Circular A-133, Subpart C, section .300 states in part:

"The auditee shall: . . . (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs."

The failure to establish internal controls could enable material noncompliance to go undetected. Noncompliance of the grant agreement or the compliance requirements could result in the loss of federal funds.

We recommended that the OCRA's management develop and implement procedures to document management approval of the PER prior to it being submitted to U.S. Department of Housing and Urban Development.

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

FINDING 2014-008 - SUBRECIPIENT MONITORING

Federal Agency: U.S. Department of Housing and Urban Development
Federal Program: Community Development Block Grants/State's Program
and Non-Entitlement Grants in Hawaii

CFDA Number: 14.228

Federal Award Number and Year (or Other Identifying Number): B-05-DC-180001, B-06-DC-18-0001,
B-07-DC-18-0001, B-08-DC-18-0001,
B-08-DF-18-0001, B-08-DI-18-0001,
B-09-DC-18-0001, B-10-DC-18-0001,
B-11-DC-18-0001, B-12-DC-18-0001,
B-13-DC-18-0001, and B-08-DI-18-0001

Management of the Indiana Office of Community and Rural Affairs (OCRA) has not established an effective internal control system over the Subrecipient Monitoring compliance requirement. Controls were not in place to ensure all subrecipients were monitored for compliance with laws, regulations, and the provisions of grant agreements. Additionally, controls were not in place to ensure all subrecipients obtained the required audits in accordance with OMB Circular A-133. Employees of the OCRA maintained monitoring schedules to ensure audits were properly completed; however, there were not any controls in place to ensure that the schedules were properly maintained.

OMB Circular A-133, Subpart C, section .300 states in part:

"The auditee shall: . . . (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs."

The failure to establish internal controls could enable material noncompliance to go undetected. Non-compliance of the grant agreement or the compliance requirements could result in the loss of federal funds.

We recommended that the OCRA's management develop and implement procedures to ensure the Subrecipient Monitoring requirements are met.

FINDING 2014-009 - SPECIAL TESTS AND PROVISIONS - MATCH OF IRS 940 FUTA TAX FORM

Federal Agency: U.S. Department of Labor
Federal Program: Unemployment Insurance
CFDA Number: 17.225

Federal Award Number and Year (or Other Identifying Number): UI-21098-11-55-A-18,
UI-22275-12-55-A-18,
UI-23890-13-55-A-18,
UI-25202-14-55-A-18, ESTIMATE

Management of the Indiana Department of Workforce Development (DWD) has not established an effective internal control system over the Special Tests and Provisions - Match of IRS 940 FUTA Tax Form compliance requirement.

The DWD could not provide tangible evidence that controls are in place to ensure the accuracy of the data used in the IRS 940 FUTA match. The failure to establish these controls could enable material noncompliance to go undetected.

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

OMB Circular A-133, Subpart C, section .300 states in part:

"The auditee shall: . . . (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs."

We recommended that the DWD establish controls that provide tangible evidence that the review of the reports, which is required by the Internal Revenue Service, is performed.

***FINDING 2014-010 - SPECIAL TESTS AND PROVISIONS -
UC PROGRAM INTEGRITY - OVERPAYMENTS***

Federal Agency: U.S. Department of Labor

Federal Program: Unemployment Insurance

CFDA Number: 17.225

Federal Award Number and Year (or Other Identifying Number): UI-21098-11-55-A-18,
UI-22275-12-55-A-18,
UI-23890-13-55-A-18,
UI-25202-14-55-A-18, ESTIMATE

Management of the Indiana Department of Workforce Development (DWD) has not established an effective internal control system related to the Special Tests and Provisions - UC Program Integrity - Overpayments compliance requirement.

The DWD does not have adequate controls in place to ensure that the compliance requirement is met with respect to the handling of overpayments and fraud penalty charges. The following control deficiencies were identified:

- The initial classification of an overpayment case as a regular overpayment or potential fraud, which is completed by a claims deputy, is not subjected to a review process to ensure that the correct classification was determined if the deputy determines it to be a regular overpayment. The Benefit Timeliness Quality (BTQ) Division reviews a sample of cases twice a month from each claims deputy; however, this review was not properly designed to mitigate the risk of noncompliance for this compliance requirement.
- Once an overpayment is determined to be potential fraud, it is forwarded to the Benefit Payment Control Division for review. Proper supporting documentation was not available for audit to document the initial supervisory review of those potential fraud cases.
- Proper supporting documentation was not available for audit to document the final review of the fraud investigator's report, supporting documentation, and final determination of fraud cases.

The failure to establish adequate controls could enable material noncompliance to go undetected. Noncompliance of the grant agreement or the compliance requirements that have a direct and material effect to the program could result in the loss of federal funds.

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

OMB Circular A-133, Subpart C, section .300 states in part:

"The auditee shall: . . . (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs."

We recommended that the DWD establish adequate controls to ensure that overpayments are properly identified and handled in accordance with the agency's policies and procedures.

***FINDING 2014-011 - SPECIAL TESTS AND PROVISIONS -
UC PROGRAM INTEGRITY - OVERPAYMENTS***

Federal Agency: U.S. Department of Labor

Federal Program: Unemployment Insurance

CFDA Number: 17.225

Federal Award Number and Year (or Other Identifying Number): UI-21098-11-55-A-18,
UI-22275-12-55-A-18,
UI-23890-13-55-A-18,
UI-25202-14-55-A-18, ESTIMATE

The Indiana Department of Workforce Development (DWD) enacted Indiana Code 22-4-11-1.5 to meet the requirements of 26 USC 3303 subsection (a)(1). This law went into effect July 1, 2013.

Indiana Code 22-4-11-1.5 states:

"(a) As used in this section, 'erroneous payment' means a payment that would not have been made but for the failure by an employer or a person acting on behalf of the employer with respect to a claim for unemployment benefits to which the payment relates.

(b) As used in this section, 'pattern of failure' means a repeated and documented failure by an employer or a person acting on behalf of an employer to respond to requests for information made by the department, taking into consideration the number of failures in relation to the total number of requests received by the employer or the person acting on behalf of an employer.

(c) The experience account of an employer may not be relieved of charges for a benefit overpayment from the state's unemployment insurance benefit fund established by IC 22-4-26-1, if the department determines that:

- (1) the erroneous payment was made because the employer or a person acting on behalf of the employer was at fault in failing to respond in a timely or adequate manner to the department's written request for information relating to the claim for unemployment benefits; and
- (2) the employer or a person acting on behalf of the employer has established a pattern of failure to respond in a timely or adequate manner to department requests described in subdivision (1)."

The DWD's management is in the process of developing policies and procedures to determine and track a "pattern of failure" for employers in order to implement this law; however, during our audit period, and as of the date of this report, this has not been implemented.

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

26 USC 3303 as amended by Public Law 112-40, title II, §252, Oct. 21, 2011, 125 Stat. 421, 422 states in part:

"(f) Prohibition on noncharging due to employer fault

(1) In general A State law shall be treated as meeting the requirements of subsection (a)(1) only if such law provides that an employer's account shall not be relieved of charges relating to a payment from the State unemployment fund if the State agency determines that—

(A) the payment was made because the employer, or an agent of the employer, was at fault for failing to respond timely or adequately to the request of the agency for information relating to the claim for compensation; and

(B) the employer or agent has established a pattern of failing to respond timely or adequately to such requests.

(2) State authority to impose stricter standards

Nothing in paragraph (1) shall limit the authority of a State to provide that an employer's account not be relieved of charges relating to a payment from the State unemployment fund for reasons other than the reasons described in subparagraphs (A) and (B) of such paragraph, such as after the first instance of a failure to respond timely or adequately to requests described in paragraph (1)(A)."

Noncompliance of the grant agreement or the compliance requirements could result in the loss of federal funds.

We recommended that the DWD establish a system that can track employers' responses for timeliness and accuracy to establish a pattern of failure to ensure that an employer, who is determined to be untimely in their response or does not provide accurate information, is not relieved of the Unemployment Insurance benefit charges.

FINDING 2014-012 - CASH MANAGEMENT

Federal Agency: U.S. Department of Transportation
Federal Program: Highway Planning and Construction
CFDA Number: 20.205

Federal Award Number and Year (or Other Identifying Number): Estimated \$, RTA-000-1661,
various, N4510.770

Management of the Indiana Department of Transportation (INDOT) has not established an effective internal control system over the Cash Management compliance requirement. The failure to establish an effective internal control system resulted in noncompliance with the compliance requirement. Noncompliance of the grant agreement or the compliance requirement could result in the loss of federal funds to the State of Indiana.

Policies and procedures were not in place to monitor subrecipients for Cash Management compliance requirements; therefore, no monitoring was performed to ensure subrecipients minimized the time elapsing between the transfer of federal funds from INDOT and the disbursement of funds by the subrecipient for program purposes.

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

OMB Circular A-133, Subpart C, section .300 states in part:

"The auditee shall: . . . (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs."

49 CFR 18.37(a) states in part:

"*States.* States shall follow state law and procedures when awarding and administering subgrants (whether on a cost reimbursement or fixed amount basis) of financial assistance to local and Indian tribal governments. States shall:

- (1) Ensure that every subgrant includes any clauses required by Federal statute and executive orders and their implementing regulations;
- (2) Ensure that subgrantees are aware of requirements imposed upon them by Federal statute and regulation;
- (3) Ensure that a provision for compliance with §18.42 is placed in every cost reimbursement subgrant; and
- (4) Conform any advances of grant funds to subgrantees substantially to the same standards of timing and amount that apply to cash advances by Federal agencies."

49 CFR 18.26(b) states in part:

"*Subgrantees.* State or local governments, as those terms are defined for purposes of the Single Audit Act Amendments of 1996, that provide Federal awards to a subgrantee, which expends \$300,000 or more (or other amount as specified by OMB) in Federal awards in a fiscal year, shall:
. . .

- (2) Determine whether the subgrantee spent Federal assistance funds provided in accordance with applicable laws and regulations. This may be accomplished by reviewing an audit of the subgrantee made in accordance with the Act, Circular A-110, or through other means (e.g., program reviews) if the subgrantee has not had such an audit; . . ."

We recommended that the INDOT's management establish policies and procedures to monitor sub-recipients for Cash Management requirements.

FINDING 2014-013 - REPORTING

Federal Agency: U.S. Department of Transportation

Federal Program: Highway Planning and Construction, Recreational Trails Program

CFDA Number: 20.205, 20.219

Federal Award Number and Year (or Other Identifying Number): Estimated \$, RTA-000-1661, various, N4510.770, RT08(002), RT08(007), RT09(006), RT09(003), RT09(004), RT10(009), FT10(010), RT09(007), RT10(007), RT10(008), RT09(005), RT11(010), RT11(006), RT11(005), RT12(003), RT12(005), RT12(007)

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

Management of the Indiana Department of Transportation (INDOT) and the Indiana Department of Natural Resources (DNR) have not established an effective internal control system to ensure compliance with the Federal Funding Accountability and Transparency Act (FFATA). The INDOT and the DNR did grant subawards that would require that the FFATA report be filed; however, they did not provide documentation that an effort was made to file the report in the Federal Subaward Reporting System (FSRS), as required.

Failure to establish internal controls resulted in noncompliance with the FFATA requirement set forth by the Office of Management and Budget. Noncompliance of the grant agreement or the compliance requirements that have a direct and material effect to the program could result in the loss of federal funds.

OMB Circular A-133, Subpart C, section .300 states in part:

"The auditee shall: . . . (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs."

2 CFR Part 170 Appendix A Award Term states in part:

"Unless you are exempt as provided in paragraph d. of this award term, you must report each action that obligates \$25,000 or more in Federal funds that does not include Recovery funds (as defined in section 1512(a)(2) of the American Recovery and Reinvestment Act of 2009, Pub. L. 111-5) for a subaward to an entity (see definitions in paragraph e. of this award term). . . . d. *Exemptions.* If, in the previous tax year, you had gross income, from all sources under \$300,000, you are exempt from the requirements to report . . ."

We recommended that the INDOT and the DNR develop and implement procedures and controls to ensure required reports are filed.

FINDING 2014-014 DAVIS-BACON ACT

Federal Agency: U.S. Department of Transportation
Federal Program: Highway Planning and Construction
CFDA Number: 20.205

Federal Award Number and Year (or Other Identifying Number): NHTSA, Various, A249-11-320136, A249-11-320824, A249-11-320470, A249-11-320136, N4510.770, Estimated \$, RTA-000-1661

Management of the Indiana Department of Transportation (INDOT) did not establish an effective internal control system over the Davis-Bacon Act compliance requirement. Controls were not in place to ensure the District Offices of the INDOT received all weekly certified payrolls from contractors and subcontractors for weeks in which work was completed. Based upon information provided by the INDOT, we were unable to determine if we received all weekly certified payrolls for the audit period to test. The District Offices maintained weekly payrolls that had been submitted and certified by the contractors; however, no records were kept to track if work was completed each week and if a certified payroll should have been submitted.

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

OMB Circular A-133, Subpart C, section .300 states in part:

"The auditee shall: . . . (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs."

29 CFR part 3.3(b) states in part:

"Each contractor or subcontractor engaged in the construction, prosecution, completion, or repair of any public building or public work, or building or work financed in whole or in part by loans or grants from the United States, shall furnish each week a statement with respect to the wages paid each of its employees engaged on work covered by this part 3 and part 5 of this title during the preceding weekly payroll period."

Failure to establish internal controls resulted in noncompliance to the compliance requirement. Non-compliance of the grant agreement or the compliance requirements that have a direct and material effect to the program could result in the loss of federal funds.

We recommended that the INDOT's management develop and implement procedures and controls to ensure that all weekly certified payrolls are received for work completed on construction contracts.

FINDING 2014-015 - SPECIAL TESTS AND PROVISIONS

Federal Agency: U.S. Department of Transportation
Federal Program: Highway Planning and Construction
CFDA Number: 20.205

Federal Award Number and Year (or Other Identifying Number): NHTSA, Various, A249-11-320136, A249-11-320824, A249-11-320470, A249-11-320136, N4510.770, Estimated \$, RTA-000-1661

Management of the Indiana Department of Transportation (INDOT) has not established an effective internal control system over the Special Tests and Provisions - Utilities compliance requirement.

Plans, Specifications, and Estimate (PS&E) packages for projects using Federal-aid highway program funds are required to include a utility agreement, or statement, verifying the appropriate coordination with all utilities on the projects had occurred prior to the Federal Highway Administration (FHWA) construction authorization. We were unable to identify any controls in place that would ensure that this agreement or statement is included in the PS&E packages prior to submitting to the FHWA for approval.

OMB Circular A-133, Subpart C, section .300 states in part:

"The auditee shall: . . . (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs."

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

Failure to establish internal controls could enable material noncompliance to go undetected. Non-compliance of the grant agreement or the compliance requirements that have a direct and material effect to the program could result in the loss of federal funds.

We recommended that the INDOT's management develop and implement procedures and controls to ensure that all PS&E packages include the required utility agreement or statement prior to submission to the FHWA for approval.

FINDING 2014-016 - SUBRECIPIENT MONITORING

Federal Agency: U.S. Department of Transportation
Federal Program: Highway Planning and Construction
CFDA Number: 20.205

Federal Award Number and Year (or Other Identifying Number): NHTSA, Various, A249-11-320136, A249-11-320824, A249-11-320470, A249-11-320136, N4510.770, Estimated \$, RTA-000-1661

Management of the Indiana Department of Transportation (INDOT) has not established an effective internal control system over the Subrecipient Monitoring compliance requirement. The failure to establish an effective internal control system resulted in noncompliance with the compliance requirement. The INDOT could not provide documentation of monitoring activities to ensure the subrecipients complied with all applicable federal requirements. Additionally, the INDOT is required to monitor subrecipients to ensure the subrecipient obtained an audit in accordance with the OMB Circular A-133. While the INDOT provided a schedule that monitored subrecipient audits, we identified 44 subrecipients that were not included on the schedule and therefore not properly monitored for the required audit.

OMB Circular A-133, Subpart C, section .300 states in part:

"The auditee shall: . . . (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs."

49 CFR 18.40(a) states:

"*Monitoring by grantees.* Grantees are responsible for managing the day-to-day operations of grant and subgrant supported activities. Grantees must monitor grant and subgrant supported activities to assure compliance with applicable Federal requirements and that performance goals are being achieved. Grantee monitoring must cover each program, function or activity."

49 CFR 18.26(b) states in part:

"*Subgrantees.* State or local governments, as those terms are defined for purposes of the Single Audit Act Amendments of 1996, that provide Federal awards to a subgrantee, which expends \$300,000 or more (or other amount as specified by OMB) in Federal awards in a fiscal year, shall: . . .

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

- (2) Determine whether the subgrantee spent Federal assistance funds provided in accordance with applicable laws and regulations. This may be accomplished by reviewing an audit of the subgrantee made in accordance with the Act, Circular A-110, or through other means (e.g., program reviews) if the subgrantee has not had such an audit; . . ."

Failure to establish internal controls resulted in noncompliance to the compliance requirement. Non-compliance of the grant agreement or the compliance requirements that have a direct and material effect to the program could result in the loss of federal funds.

We recommended that the INDOT's management establish policies and procedures to ensure compliance with the Subrecipient Monitoring requirements.

FINDING 2014-017 - SPECIAL TESTS AND PROVISIONS

Federal Agency: U.S. Department of Transportation
Federal Program: Highway Planning and Construction
CFDA Number: 20.205
Federal Award Number and Year (or Other Identifying Number): NHTSA, Various, A249-11-320136, A249-11-320824, A249-11-320470, A249-11-320136, N4510.770, Estimated \$, RTA-000-1661

The Indiana Department of Transportation (INDOT) did not establish an effective internal control system over the Special Test and Provisions - Quality Assurance Program compliance requirement. The INDOT employees did not review the QA Program activities performed by qualified testing personnel until the project was complete, which could be several years after the QA Program activities were performed. Due to the timing of this review, any errors in the QA program activities would not be identified timely.

OMB Circular A-133, Subpart C, section .300 states in part:

"The auditee shall: . . . (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs."

The failure to establish internal controls could enable material noncompliance to go undetected. Noncompliance of the grant agreement or the compliance requirements could result in the loss of federal funds.

We recommended that the INDOT's management establish controls related to the Special Tests and Provisions - Quality Assurance compliance requirement.

FINDING 2014-018 - SUSPENSION AND DEBARMENT

Federal Agency: U.S. Department of Education
Federal Program: School Improvement Grants, ARRA - School Improvement Grants, Recovery Act
CFDA Number: 84.377, 84.388
Federal Award Number and Year (or Other Identifying Number): S377A100015, S377A110015, S388A090015

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

Management of the Indiana Department of Education (DOE) has not designed and implemented an effective internal control system over the Suspension and Debarment compliance requirement for program subrecipients. The DOE awards subgrants to local educational agencies; however, the DOE does not verify that the local educational agencies are not excluded or disqualified.

OMB Circular A-133, Subpart C, section .300 states in part:

"The auditee shall: . . . (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs."

2 CFR 180.300 states:

"When you enter into a covered transaction with another person at the next lower tier, you must verify that the person with whom you intend to do business is not excluded or disqualified.

You do this by:

- (a) Checking the EPLS; or
- (b) Collecting a certification from that person; or
- (c) Adding a clause or condition to the covered transaction with that person."

2 CFR 180.215 states:

"The following types of nonprocurement transactions are not covered transactions:

- (a) A direct award to—
 - (1) A foreign government or foreign governmental entity;
 - (2) A public international organization;
 - (3) An entity owned (in whole or in part) or controlled by a foreign government; or
 - (4) Any other entity consisting wholly or partially of one or more foreign governments or foreign governmental entities.
- (b) A benefit to an individual as a personal entitlement without regard to the individual's present responsibility (but benefits received in an individual's business capacity are not excepted). For example, if a person receives social security benefits under the Supplemental Security Income provisions of the Social Security Act, 42 U.S.C. 1301 *et seq.*, those benefits are not covered transactions and, therefore, are not affected if the person is excluded.
- (c) Federal employment.
- (d) A transaction that a Federal agency needs to respond to a national or agency-recognized emergency or disaster.

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

- (e) A permit, license, certificate or similar instrument issued as a means to regulate public health, safety or the environment, unless a Federal agency specifically designates it to be a covered transaction.
- (f) An incidental benefit that results from ordinary governmental operations.
- (g) Any other transaction if—
 - (1) The application of an exclusion to the transaction is prohibited by law; or
 - (2) A Federal agency's regulation exempts it from coverage under this part."

The failure to establish internal controls could enable material noncompliance to go undetected. Non-compliance of the grant agreement or the compliance requirements that have a direct and material effect to the program could result in the loss of federal funds.

We recommended that the DOE's management establish controls to ensure the Suspension And Debarment compliance requirement has been met.

FINDING 2014-019 - ELIGIBILITY, EARMARKING, AND REPORTING

Federal Agency: U.S. Department of Education
Federal Program: School Improvement Grants, ARRA - School Improvement Grants, Recovery Act
CFDA Number: 84.377, 84.388
Federal Award Number and Year (or Other Identifying Number): S377A100015, S377A110015,
S388A090015

Management of the Indiana Department of Education (DOE) has not established an effective internal control system, which would include segregation of duties, related to the grant agreement and the following compliance requirements: Eligibility, Earmarking, and Reporting. Controls are not in place that would prevent, or detect and correct, material noncompliance.

There was no segregation of duties over these requirements; one person is responsible for ensuring compliance with each of the requirements. There were not any controls identified which would ensure that any errors or noncompliance with these requirements would be detected.

The failure to establish an effective internal control system places the DOE at risk of noncompliance with the grant agreement and the compliance requirements. A lack of segregation of duties within an internal control system could also allow noncompliance with compliance requirements and allow the misuse and mismanagement of federal funds and assets by not having proper oversight, reviews, and approvals over the activities of the program.

An internal control system, including segregation of duties, should be designed and operate effectively to provide reasonable assurance that material noncompliance with the grant agreement or a compliance requirement of a federal program will be prevented, or detected and corrected, on a timely basis. In order to have an effective internal control system, it is important to have proper segregation of duties. This is accomplished by making sure proper oversight, reviews, and approvals take place and to have a separation of functions over certain activities related to the program. The fundamental premise of segregation of duties is that an individual or small group of individuals should not be in a position to initiate, approve, undertake, and review the same activity.

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

OMB Circular A-133, Subpart C, section .300 states in part:

"The auditee shall: . . . (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs."

We recommended that the DOE's management establish controls, including segregation of duties, related to the grant agreement and compliance requirements listed above.

FINDING 2014-020 - SUBRECIPIENT MONITORING

Federal Agency: U.S. Department of Education

Federal Program: School Improvement Grants, ARRA - School Improvement Grants, Recovery Act

CFDA Number: 84.377, 84.388

Federal Award Number and Year (or Other Identifying Number): S377A100015, S377A110015,
S388A090015

Management of the Indiana Department of Education (DOE) has not established an effective internal control system over the Subrecipient Monitoring compliance requirement. The failure to establish an effective internal control system resulted in noncompliance with the compliance requirement. The DOE could not provide documentation that any monitoring activities were performed to ensure the subrecipients complied with all applicable federal requirements. Additionally, DOE is required to monitor subrecipients to ensure the subrecipient obtained an audit in accordance with OMB Circular A-133. The DOE maintained a monitoring schedule to document when these audits were required to be completed; however, there were not any controls in place to ensure that the schedule was properly maintained.

OMB Circular A-133, Subpart C, section .300 states in part:

"The auditee shall: . . . (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs."

34 CFR 80.40(a) states in part:

"Monitoring by grantees. Grantees are responsible for managing the day-to-day operations of grant and subgrant supported activities. Grantees must monitor grant and subgrant supported activities to assure compliance with applicable Federal requirements and that performance goals are being achieved. Grantee monitoring must cover each program, function or activity."

The failure to establish internal controls could enable material noncompliance to go undetected. Non-compliance of the grant agreement or the compliance requirements that have a direct and material effect to the program could result in the loss of federal funds.

We recommended that the DOE's management establish controls to ensure the Subrecipient Monitoring compliance requirements have been met.

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

FINDING 2014-021 - REPORTING

Federal Agency: U.S. Department of Agriculture
Federal Program: School Breakfast Program, National School Lunch Program,
Special Milk Program for Children, Summer Food Service Program for Children,
Child and Adult Care Food Program
CFDA Number: 10.553, 10.555, 10.556, 10.559, 10.558
Federal Award Number and Year (or Other Identifying Number): 2IN300059, Commodities,
2IN300260, 2IN300068

The Indiana Department of Education (DOE) has not established an effective internal control system to ensure the DOE's compliance with the Federal Funding Accountability and Transparency Act (FFATA). The DOE did grant subawards that would require that the FFATA report be filed; however, the DOE did not provide documentation that an effort was made to file the report in the Federal Subward Reporting System (FSRS), as required.

Failure to establish internal controls resulted in noncompliance with the FFATA requirement set forth by the Office of Management and Budget. Noncompliance of the grant agreement or the compliance requirements that have a direct and material effect to the program could result in the loss of federal funds.

OMB Circular A-133, Subpart C, section .300 states in part:

"The auditee shall: . . . (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs."

2 CFR Part 170 Appendix A Award Term states in part:

"Unless you are exempt as provided in paragraph d. of this award term, you must report each action that obligates \$25,000 or more in Federal funds that does not include Recovery funds (as defined in section 1512(a)(2) of the American Recovery and Reinvestment Act of 2009, Pub. L. 111-5) for a subaward to an entity (see definitions in paragraph e. of this award term). . . . d. *Exemptions.* If, in the previous tax year, you had gross income, from all sources under \$300,000, you are exempt from the requirement to report . . ."

We recommended that the DOE develop and implement procedures and controls to ensure an effort is made to comply with the submission process.

FINDING 2014-022 - ELIGIBILITY

Federal Agency: U.S. Department of Agriculture
Federal Program: Child and Adult Care Food Program
CFDA Number: 10.558
Federal Award Number and Year (or Other Identifying Number): 2IN300260, 2IN300059, 2IN300068

Management of the Indiana Department of Education (DOE) has not established an effective internal control system, which would include segregation of duties, related to the grant agreement and the Eligibility compliance requirement.

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

The DOE uses a web application, called CNP web, which has been developed to monitor the sponsors that participate in the Child and Adult Care Food Program (CACFP). For sponsoring organizations whose initial eligibility determination was made prior to implementation of CNP Web in 2003, documentation was not provided to show that the initial eligibility determination was subjected to a review process.

The failure to establish an effective internal control system places the DOE at risk of noncompliance with the grant agreement and the compliance requirements. A lack of segregation of duties within an internal control system could also allow noncompliance with compliance requirements and allow the misuse and mismanagement of federal funds and assets by not having proper oversight, reviews, and approvals over the activities of the program.

An internal control system, including segregation of duties, should be designed and operate effectively to provide reasonable assurance that material noncompliance with the grant agreement or a compliance requirement of a federal program will be prevented, or detected and corrected, on a timely basis. In order to have an effective internal control system, it is important to have proper segregation of duties. This is accomplished by making sure proper oversight, reviews, and approvals take place and to have a separation of functions over certain activities related to the program. The fundamental premise of segregation of duties is that an individual or small group of individuals should not be in a position to initiate, approve, undertake, and review the same activity.

OMB Circular A-133, Subpart C, section .300 states in part:

"The auditee shall: . . . (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs."

The failure to establish internal controls could enable material noncompliance to go undetected. Non-compliance of the grant agreement or the compliance requirements could result in the loss of federal funds.

We recommended that the DOE's management establish controls, including segregation of duties, related to the grant agreement and the Eligibility compliance requirement.

***FINDING 2014-023 - ACTIVITIES ALLOWED OR UNALLOWED,
ALLOWABLE COSTS/COST PRINCIPLES, REPORTING***

Federal Agency: U.S. Department of Health and Human Services

Federal Program: Medical Assistance Program, Children's Health Insurance Program

CFDA Number: 93.778, 93.767

Federal Award Number and Year (or Other Identifying Number): HIT-INCTPAY13, HIT-IMP13,
1305IN5ADM, 1405ININCT, 1405INIMPL,
1005in5map, XIX-MAP13, 05-1305INBIPP,
XIX-MAP14, 05-1405INBIPP, 1205IN5021,
1305IN5021

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

Management of the Indiana Family and Social Services Administration (FSSA) has not established an effective internal control system over the Activities Allowed or Unallowed, Allowable Costs/Cost Principles, and Reporting compliance requirements. The FSSA used two different summary level reports, the summary financial reports and the summary claim reports, provided by their fiscal agency, Hewlett Packard (HP), for financial accounting and reporting purposes. The FSSA has not developed controls to ensure that the summary level data provided is supported by detailed transactions that are allowable and accurate for reporting purposes.

- The FSSA used the summary financial reports to record expenditures of the Medicaid Assistance Program (Medicaid) and the Children's Health Insurance Program (CHIP) in the State of Indiana's (State) financial accounting system. The summary financial reports provided a summary total of actual disbursements paid by HP, with no supporting detail provided of actual amounts paid.
- The FSSA used different summary claim reports provided by HP to complete the required quarterly Centers for Medicare and Medical Services (CMS) reports for Medicaid and CHIP. The summary claim reports provide a summary total of amounts claimed by providers, with no claim level detail of differences between the amounts entered into the accounting system and the CMS summary reports.

Reconciliations between the quarterly CMS reports and the financial reports were performed by the FSSA to ensure all required amounts were reported on the CMS reports, in addition to ensuring all amounts were properly recorded in the State's financial accounting system. Although this reconciliation could be a control, it used summarized data instead of detail data. Additionally, there were no controls documented over this reconciliation to ensure it was being completed timely and accurately.

OMB Circular A-133, Subpart C, section .300 states in part:

"The auditee shall: . . . (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs."

The failure to establish an effective internal control system places the FSSA at risk of noncompliance with the grant agreement and the Activities Allowed or Unallowed, Allowable Costs/Cost Principles, and Reporting compliance requirements. Noncompliance of the grant agreement or the compliance requirements could result in the loss of federal funds.

We recommended that the FSSA's management establish controls related to the grant agreement and compliance requirements listed above.

FINDING 2014-024 - REPORTING

Federal Agency: Social Security Administration
Federal Program: Social Security - Disability Insurance and Supplemental Security Income
CFDA Numbers: 96.001
Federal Award Number and Year (or Other Identifying Number): 1304IND100

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

Management of the Indiana Family and Social Services Administration (FSSA) did not implement an effective internal control system over the Reporting compliance requirement to ensure supporting documentation agreed to amounts reported. The FSSA prepared the required quarterly SSA-4514, Time Reports of Personnel Services for Disability Determination Services, from information generated by the Auditor of State payroll system. Our testing of the SSA-4514 report for the quarter ended March 31, 2014, revealed that the On Duty Hours, Holiday and Leave Hours, and Overtime Hours reported on the SSA-4514 report did not agree with the corresponding Auditor of State payroll system report presented for audit.

OMB Circular A-133, Subpart C, section .300 states in part:

"The auditee shall: . . . (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs."

2 CFR 200.302(a) states:

"Each state must expend and account for the Federal award in accordance with state laws and procedures for expending and accounting for the state's own funds. In addition, the state's and the other non-Federal entity's financial management systems, including records documenting compliance with Federal statutes, regulations, and the terms and conditions of the Federal award, must be sufficient to permit the preparation of reports required by general and program-specific terms and conditions; and the tracing of funds to a level of expenditures adequate to establish that such funds have been used according to the Federal statutes, regulations, and the terms and conditions of the Federal award."

The failure to establish internal controls enabled material noncompliance to go undetected. Non-compliance of the grant agreement or the compliance requirements that have a direct and material effect to the program could result in the loss of federal funds.

We recommended that the FSSA establish controls to ensure the reports filed have the proper supporting documentation to support amounts reported.

***FINDING 2014-025 - ACTIVITIES ALLOWED OR UNALLOWED,
ALLOWABLE COSTS/COST PRINCIPLES, ELIGIBILITY***

Federal Agency: U.S. Department of Health and Human Services

Federal Program: Temporary Assistance to Needy Families

CFDA Number: 93.558

Federal Award Number and Year (or Other Identifying Number): G-1002INTANF, 1102INTANF,
1202INTANF, 1302INTANF,
1402INTANF

Management of the Indiana Family and Social Services Administration (FSSA) has not established an effective internal control system over the Activities Allowed or Unallowed, Allowable Costs/Cost Principles, and Eligibility compliance requirements. Controls were not in place to ensure all required documentation to support eligibility determinations was available for audit. In order to be allowable, the recipient must be eligible to receive benefits.

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

Due to lack of supporting documentation, we could not always verify eligibility items selected for testing. In order to be eligible for Temporary Assistance to Needy Families, at a minimum, a family must have one minor child living with a parent or other caretaker relative. Documentation was not always available to determine if the applicant was the parent of the child or had legal guardianship. A birth certificate or court order to support this requirement is needed.

OMB Circular A-133, Subpart C, section .300 states in part:

"The auditee shall: . . . (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs."

45 CFR 205.60 states in part:

"A State plan under title I, IV—A, X, XIV, or XVI (AABD) of the Social Security Act must provide that:

(a) The state agency will maintain or supervise the maintenance of records necessary for the proper and efficient operation of the plan, including records regarding applications, determinations of eligibility, the provisions of financial assistance, and the use of any information obtained under section 205.55, with respect to individuals denied, recipients whose benefits have been terminated, recipients whose benefits have been modified, and the dollar value of those denials, terminations and modifications. Under this requirement, the agency will keep individual records which contain pertinent facts about each applicant and recipient. The records will include information concerning the date of application and the date and basis of its disposition; facts essential to the determination of initial and continuing eligibility; and the basis for discontinuing assistance."

The failure to establish effective internal controls could enable material noncompliance to go undetected. Noncompliance of the grant agreement or the compliance requirements could result in the loss of federal funds.

We recommended that control procedures be implemented to protect the retention and accessibility of case files.

***FINDING 2014-026 - ACTIVITIES ALLOWED OR UNALLOWED,
ALLOWABLE COSTS/COST PRINCIPLES, ELIGIBILITY***

Federal Agency: U.S. Department of Health and Human Services

Federal Program: Temporary Assistance for Needy Families

CFDA Number: 93.558

Federal Award Number and Year (or Other Identifying Number): 1202INTANF, 1302INTANF, ESTIMATE

Management of the Indiana Department of Child Services (DCS) has not established an effective internal control system, which would include segregation of duties, related to the grant agreement and the following compliance requirements associated with the Healthy Families and Emergency Assistance Programs paid for with Temporary Assistance to Needy Families (TANF) funds: Activities Allowed or Unallowed, Allowable Costs/Cost Principles, and Eligibility.

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

Emergency Assistance Program

The Emergency Assistance Program is administered by the DCS. Expenditures were incurred and originally paid with State of Indiana (State) funds or other Federal Program funds. Once the expenditure was determined to be an eligible and allowable expenditure of the Emergency Assistance Program, a journal entry was made to move those expenditures to a federal project ID. At that time, the expenditure was reported as a TANF expenditure. Once moved to the federal project, a draw packet was prepared. These draw packets included a detail of expenditures charged to the Emergency Assistance Program. The draw packet was then sent to the Indiana Family and Social Services Administration, who then requested the funds from the U.S. Department of Health and Human Services. We could not identify any control in place that would ensure expenditures charged to the Emergency Assistance Program were eligible and allowable.

Healthy Families Program

The Healthy Families Program is administered by the DCS. The DCS contracts with providers throughout the State, who determines if families are eligible to receive services of the program and what service should be provided. If determined eligible, program services are provided to the families in accordance the program plan.

Eligibility

The DCS contracts with a company that provides its services via two separate teams, one to provide oversight of the Healthy Families Program providers and a another team to provide Quality Assurance. The Quality Assurance team performs annual audits of the providers to ensure they are properly determining eligibility. During the audit period, the DCS relied on the Quality Assurance annual audits for their control over the Eligibility compliance requirement. The DCS did not have any oversight of the audit to ensure all providers received an audit or that the findings of the audit were communicated to the providers and corrected timely.

Activities Allowed or Unallowed, Allowable Costs/Cost Principles

Provider invoices are submitted to the DCS for payment. These invoices are summary level data and did not provide detail by case of the services provided. The DCS approves these invoices for payment without reviewing to ensure the services provided were in compliance with the Activities Allowed or Unallowed, or Allowable Costs/Cost Principles compliance requirements.

OMB Circular A-133, Subpart C, section .300 states in part:

"The auditee shall: . . . (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs."

The failure to establish internal controls could enable material noncompliance to go undetected. Non-compliance of the grant agreement or the compliance requirements could result in the loss of federal funds.

We recommended that the DCS's management establish controls to ensure the expenditures charged were in compliance with the Activities Allowed or Unallowed, Allowable Costs/Costs Principles, and Eligibility compliance requirements.

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

FINDING 2014-027 - CASH MANAGEMENT AND PERIOD OF AVAILABILITY

Federal Agency: U.S. Department of Health and Human Services
Federal Program: Child Support Enforcement, Foster Care - Title IV-E, and Adoption Assistance - Title IV-E
CFDA Number: 93.563, 93.658, 93.659
Federal Award Number and Year (or Other Identifying Number): 1304IN4005, 1404IN4005,
0804INHMHR, 1004IN400, 1104IN4004,
1204IN4005, 62300, 0804INHMHR,
1201IN1401, 1301IN1401, 1401IN1401,
1101IN1407, 1201IN1407, 1301IN1407,
14101IN1407

Management of the Indiana Department of Child Services (DCS) has not established an effective internal control system over the following compliance requirements: Cash Management and Period of Availability.

The State of Indiana (State) pays 100 percent of the DCS expenditures and DCS periodically bills the U.S. Department of Health and Human Services for the federal portion of the Child Support Enforcement, Foster Care - Title IV-E, and Adoption Assistance - Title IV-E expenditures. This procedure is referred to as a federal draw. For Cash Management, the federal expenditures are required to be paid by the State prior to the federal draw. For Period of Availability, expenditures are required to be reimbursed for the correct time period. The procedures established by the DCS require that management reviews and signs the draw packet prior to the actual draw taking place. Our testing identified instances in which this review did not occur.

An internal control system should be designed and operate effectively to provide reasonable assurance that material noncompliance with the grant agreement or a compliance requirement of a federal program will be prevented, or detected and corrected, on a timely basis.

OMB Circular A-133, Subpart C, section .300 states in part:

"The auditee shall: . . . (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs."

The failure to establish internal controls could enable material noncompliance to go undetected.

We recommended that the DCS's management establish controls, including segregation of duties, related to the grant agreement and compliance requirements listed above.

FINDING 2014-028 - REPORTING

Federal Agency: U.S. Department of Health and Human Services
Federal Program: Child Support Enforcement
CFDA Number: 93.563
Federal Award Number and Year (or Other Identifying Number): 0804INHMHR, 1004IN400, 1104IN4004,
1204IN4005, 1304IN4005, 1404IN4005

Management of the Indiana Department of Child Services (DCS) has not established an effective internal control system over the Reporting compliance requirement.

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

The Child Support Enforcement Program Financial Report (OCSE 396A) is required be submitted to the Administration for Children & Families (ACF) on a quarterly basis. The procedures in place to ensure the accuracy of the OCSE 396A reports failed to prevent, or detect and correct, errors in two of the four reports tested. Immaterial errors were not discovered by the DCS's staff until supporting documentation was requested for audit. At that time, the DCS's staff reviewed the reports and found the errors prior to providing them for audit.

Additionally, the DCS did grant subawards that would require that the Federal Funding Accountability and Transparency Act report be filed; however, they did not provide documentation that an effort was made to file the report in the Federal Subward Reporting System (FSRS), as required.

OMB Circular A-133, Subpart C, section .300 states in part:

"The auditee shall: . . . (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs."

2 CFR Part 170 Appendix A Award Term states in part:

"Unless you are exempt as provided in paragraph d. of this award term, you must report each action that obligates \$25,000 or more in Federal funds that does not include Recovery funds (as defined in section 1512(a)(2) of the American Recovery and Reinvestment Act of 2009, Pub. L. 111-5) for a subaward to an entity (see definitions in paragraph e. of this award term). . . . d. *Exemptions.* If, in the previous tax year, you had gross income, from all sources under \$300,000, you are exempt from the requirement to report . . ."

The failure to establish internal controls could enable material noncompliance to go undetected. Noncompliance of the grant agreement or the compliance requirements could result in the loss of federal funds.

We recommended that the DCS's management establish controls over the Reporting compliance requirement to ensure reports are correct and properly filed.

FINDING 2014-029 - SUBRECIPIENT MONITORING

Federal Agency: U.S. Department of Health and Human Services

Federal Program: Child Support Enforcement

CFDA Number: 93.563

Federal Award Number and Year (or Other Identifying Number): 0804INHMHR, 1004IN400, 1104IN4004, 1204IN4005, 1304IN4005, 1404IN4005

Management of the Indiana Department of Child Services (DCS) has not established an effective internal control system over the Subrecipient Monitoring compliance requirement. The failure to establish an effective internal control system resulted in noncompliance with the compliance requirement. The DCS could not provide documentation that any monitoring activities were performed to ensure the subrecipients complied with all applicable federal requirements. Additionally, the DCS is required to monitor subrecipients to ensure the subrecipient obtained an audit in accordance with OMB Circular A-133. The DCS maintained a monitoring schedule to document when these audits were required to be completed; however, there were not any controls in place to ensure that the schedule was properly maintained.

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

OMB Circular A-133, Subpart C, section .300 states in part:

"The auditee shall: . . . (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs."

45 CFR 92.40(a) states:

"Monitoring by grantees. Grantees are responsible for managing the day-to-day operations of grant and subgrant supported activities. Grantees must monitor grant and subgrant supported activities to assure compliance with applicable Federal requirements and that performance goals are being achieved. Grantee monitoring must cover each program, function or activity."

The failure to establish internal controls enabled material noncompliance to go undetected. Noncompliance of the grant agreement or the compliance requirements that have a direct and material effect to the program could result in the loss of federal funds.

We recommended that the DCS's management establish policies, procedures, and controls to ensure proper monitoring of subrecipients activities and required audits.

FINDING 2014-030 - CASH MANAGEMENT

Federal Agency: U.S. Department of Health and Human Services

Federal Program: Child Support Enforcement

CFDA Number: 93.563

Federal Award Number and Year (or Other Identifying Number): 0804INHMHR, 1004IN400, 1104IN4004, 1204IN4005, 1304IN4005, 1404IN4005

Management of the Indiana Department of Child Services (DCS) has not established an effective internal control system over the Cash Management compliance requirement.

The Cash Management Improvement Act Agreement (Agreement) between the State of Indiana and the Secretary of the Treasury, U.S. Department of Treasury, indicated the Child Support Enforcement grant used an Average Clearance technique to determine a one day average clearance pattern. Upon recalculating the average day of clearance using the method described in the agreement, we determined the average day of clearance to be 6 days.

Noncompliance with the grant agreement or compliance requirements that have a direct and material effect to the program could result in the loss of federal funds.

OMB Circular A-133, Subpart C, section .300 states in part:

"The auditee shall: . . . (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs."

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

31 CFR 205.1 states:

"(a) This part prescribes rules for transferring funds between the Federal government and States for Federal assistance programs. This part applies to: (1) All States as defined in §205.2; and (2) All Federal program agencies, except the Tennessee Valley Authority (TVA) and its Federal assistance programs.

(b) Only programs listed in the Catalog of Federal Domestic Assistance, as established by Chapter 61 of Title 31, United States Code (U.S.C) are covered by this part.

(c) This part does not apply to: (1) Payments made to States acting as vendors on Federal contracts, which are subject to the Prompt Payment Act of 1982, as amended, 31 U.S.C. 3901 *et seq.*, 5 CFR part 1315, and 48 CFR part 32; or (2) Direct loans from the Federal government to States."

31 CFR 205.3 states:

"(a) Generally, this subpart prescribes the rules that apply to Federal assistance programs which: (1) Are listed in the Catalog of Federal Domestic Assistance; (2) Meet the funding threshold for a major Federal assistance program; and (3) Are included in a Treasury-State agreement or default procedures.

(b) Upon a State's request, we will make additional Federal assistance programs subject to subpart A by lowering the funding threshold in the Treasury-State agreement. All of a State's programs that meet this lower threshold would be subject to this subpart A.

(c) We may make additional Federal assistance programs subject to subpart A if a State or Federal Program Agency fails to comply with subpart B of this part."

31 CFR 205.6 states:

"(a) A Treasury-State agreement documents the accepted funding techniques and methods for calculating interest agreed upon by us and a State and identifies the Federal assistance programs governed by this subpart A. If anything in a Treasury-State agreement is inconsistent with this subpart A, that part of the Treasury-State agreement will not have any effect and this subpart A will govern.

(b) A Treasury-State agreement will be effective until terminated unless we and a State agree to a specific termination date. We or a State may terminate a Treasury-State agreement on 30 days written notice."

31 CFR 205.7 states in part:

(a) We or a State may amend a Treasury-State agreement at any time if both we and the State agree in writing.

(b) The effective date of an amendment shall be the date both parties agree to the amendment in writing unless otherwise agreed to by both parties.

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

(c) We and a State must amend a Treasury-State agreement as needed to change or clarify its language when the terms of the existing agreement are either no longer correct or no longer applicable. A State must notify us in writing within 30 days of the time the State becomes aware of a change, describing the Federal assistance program change. The notification must include a proposed amendment for our review and a current list of all programs included in the Treasury-State agreement. Amendments may address, but are not limited to: (1) Additions or deletions of Federal assistance programs subject to this subpart A; (2) Changes in funding techniques; and (3) Changes in clearance patterns.

(d) Additions or deletions to the list of Federal assistance programs subject to this subpart A take effect when a Treasury-State agreement is amended, unless otherwise agreed to by the parties."

Section 6.2.1 of the Agreement between the State of Indiana and the Secretary of the Treasury, U.S. Department of Treasury states in part:

"Average Clearance - The State shall request funds such that they are deposited by ACH on the dollar-weighted average day of clearance for the disbursement, in accordance with the clearance pattern specified in Exhibit II. The request shall be made in accordance with the appropriate Federal agency cut-off time specified in Exhibit I. The amount of the request shall be for the exact amount of that disbursement. This funding technique is interest neutral."

Section 7.6 of the Agreement between the State of Indiana and the Secretary of the Treasury, U.S. Department of Treasury states:

"The State shall use the following method to calculate the dollar-weighted average day of clearance: To determine the number of days each check was outstanding (clearance time), the issue date shall be subtracted from the date the check cleared the State's account. To determine the percentage of the disbursement paid out each day following issuance, the amount of the checks that clear the State's account each day shall be summed and then divided by the amount of the total disbursement. For each day following issuance, the clearance time of the checks paid out that day shall be multiplied by the percentage of the total disbursement those checks represent. This product is the clearance factor. The dollar-weighted average day of clearance for the disbursement shall be determined by summing the clearance factor of each day following the disbursement."

Exhibit II of the Agreement between the State of Indiana and the Secretary of the Treasury, U.S. Department of Treasury shows an average day of clearance for the Child Support Enforcement grant of 1 day.

We recommended that the DCS's management establish controls over the preparation of the Agreement and to amend the Agreement in place for the current fiscal year to include the proper average day of clearance.

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

**FINDING 2014-031 - ACTIVITIES ALLOWED OR UNALLOWED,
ALLOWABLE COSTS/COST PRINCIPLES, ELIGIBILITY**

Federal Agency: Department of Health and Human Services

Federal Program: Adoption Assistance - Title IV-E

CFDA Number: 93.659

Federal Award Number and Year (or Other Identifying Number): 11101IN1407, 1201IN1407,
1301IN1407, 1401IN1407

Management of the Indiana Department of Child Services (DCS) has not established an effective internal control system over the following compliance requirements: Activities Allowed or Unallowed, Allowable Costs/Cost Principles, and Eligibility. Controls were not in place to ensure all required documentation was kept with the case files.

For 20 of the 25 cases selected for testing, the case files maintained by the DCS and the local county offices did not contain adequate documentation to support eligibility determinations; therefore, we could not determine if the recipient was an eligible recipient of Federal Adoption Assistance program funds. All 20 of those cases were initiated prior to 2009.

Compliance with Activities Allowed or Unallowed and Allowable Costs/Cost Principles requirements is dependent on the payment being made to adoptive parents in connection with an eligible child. Since we could not determine if the recipient was eligible, we could not determine if the payment was for an Allowable Activity or made in accordance with Allowable Cost/Cost Principles.

OMB Circular A-133, Subpart C, section .300 states in part:

"The auditee shall: . . . (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs."

42 USC 673 states in part:

"(1)(A) Each State having a plan approved under this part shall enter into adoption assistance agreements (as defined in section 675(3) of this title) with the adoptive parents of children with special needs.

(B) Under any adoption assistance agreement entered into by a State with parents who adopt a child with special needs, the State—

- (i) shall make payments of nonrecurring adoption expenses incurred by or on behalf of such parents in connection with the adoption of such child, directly through the State agency or through another public or nonprofit private agency, in amounts determined under paragraph (3), and
- (ii) in any case where the child meets the requirements of paragraph (2), may make adoption assistance payments to such parents, directly through the State agency or through another public or nonprofit private agency, in amounts so determined.

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

(2)(A) For purposes of paragraph (1)(B)(ii), a child meets the requirements of this paragraph if—

- (i) in the case of a child who is not an applicable child for the fiscal year (as defined in subsection (e)), the child—

(I)(aa)(AA) was removed from the home of a relative specified in section 606(a) of this title (as in effect on July 16, 1996) and placed in foster care in accordance with a voluntary placement agreement with respect to which Federal payments are provided under section 674 of this title (or section 603 of this title, as such section was in effect on July 16, 1996), or in accordance with a judicial determination to the effect that continuation in the home would be contrary to the welfare of the child; and

(BB) met the requirements of section 672(a)(3) of this title with respect to the home referred to in sub item (AA) of this item;

(bb) meets all of the requirements of subchapter XVI with respect to eligibility for supplemental security income benefits; or

(cc) is a child whose costs in a foster family home or child-care institution are covered by the foster care maintenance payments being made with respect to the minor parent of the child as provided in section 675(4)(B) of this title; and

(II) has been determined by the State, pursuant to subsection (c)(1) of this section, to be a child with special needs; or

- (ii) in the case of a child who is an applicable child for the fiscal year (as so defined), the child—

(I)(aa)at the time of initiation of adoption proceedings was in the care of a public or licensed private child placement agency or Indian tribal organization pursuant to—

(AA) an involuntary removal of the child from the home in accordance with a judicial determination to the effect that continuation in the home would be contrary to the welfare of the child; or

(BB) a voluntary placement agreement or voluntary relinquishment;

(bb) meets all medical or disability requirements of subchapter XVI with respect to eligibility for supplemental security income benefits; or

(cc) was residing in a foster family home or child care institution with the child's minor parent, and the child's minor parent was in such foster family home or child care institution pursuant to—

(AA) an involuntary removal of the child from the home in accordance with a judicial determination to the effect that continuation in the home would be contrary to the welfare of the child; or

(BB) a voluntary placement agreement or voluntary relinquishment; and (II) has been determined by the State, pursuant to subsection (c)(2), to be a child with special needs."

STATE OF INDIANA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)

The failure to establish internal controls enabled material noncompliance to go undetected. Noncompliance of the grant agreement or the compliance requirements could result in the loss of federal funds.

We recommended that DCS's management establish policies and procedures to ensure all documentation used to determine eligibility is properly maintained in the case file and available to view for audit.

SUMMARY OF 2015 LEGISLATION

Highlights of the 2015 legislative session include: (1) audit charge rate increased from \$45 to \$175 per day; (2) audit charges deposited into a dedicated State Board of Accounts fund; (3) elimination of mandatory annual and biennial audits in favor of risk-based auditing cycles; and (4) increased confidentiality of exit conferences and workpapers.

There were 9 bills enacted in 2015 that created or amended 30 Indiana Code sections giving the State Board of Accounts new or additional duties:

1. House Enrolled Act 1001

- A. IC 5-11-1-7(b) – The state examiner must allow the engagement of private examiners for any state college if the state examiner finds that the private examiner is an independent CPA firm with specific expertise in the financial affairs of educational organizations.
- B. IC 5-11-4-3(d) – SBOA shall charge each taxing unit and soil and water conservation district \$175 per day for each SBOA examiner. All other entities shall be charged the actual direct and indirect cost of performing the audit.
- C. IC 5-13-10.5-18(g) – SBOA must annually examine the Capital Improvement Board bid fund to determine the amount of deposits made and to ensure the deposits are properly used.

2. House Enrolled Act 1104

- A. IC 5-11-1-24.4(b) – SBOA must acknowledge receipt of an audited entity's request to opt out of examinations by SBOA, and approve or disapprove such request within 60 days.
- B. IC 5-11-1-24.4(d)(4) – SBOA must establish guidelines for a CPA audit of an entity opting-out of SBOA audit.
- C. IC 5-11-1-25(b) – SBOA must establish risk based audit criteria (subject to the approval of the audit committee).
- D. IC 5-11-1-25(c) – SBOA must receive notice not later than 60 days after the close of an audited entity's fiscal year that the entity requires an annual audit.
- E. IC 5-11-1-30(b) – SBOA must acknowledge receipt of an audited entity's request that its examination be conducted in accordance with GAAP, and approve or disapprove such request within 60 days.
- F. IC 5-11-5-1(b)(4) – The State Examiner may call for an additional exit conference.
- G. IC 5-11-5-1(b)(5) – The legislative body of an audited entity may request an additional exit conference. The conference must be held within 60 days of SBOA's receipt of the notice, and the legislative body must pay all SBOA travel and personnel expenses.

- H. IC 5-11-5-1(b)(6) – A final examination report may not be issued earlier than 45 days after the initial exit conference is held.
- I. IC 5-11-5-1(b), (g) –The information and materials that are part of an exit conference and the results of an examination are confidential until the earlier of: (1) the final report is made public, (2) the results of the examination are publicized, or (3) the attorney general institutes an action on the basis of a preliminary report. A violation of this statute is a Class A infraction.
- J. IC 5-11-5-1(i) – Unless in accordance with a judicial order, SBOA may not divulge examination workpapers and investigation records except to: (1) employees and members of SBOA; (2) the audit committee; (3) law enforcement officers, the attorney general, a prosecuting attorney, or any other legal representative of the state in an action with respect to the misappropriation of public funds; and (4) an authorized representative of the United States.

3. House Enrolled Act 1264

- A. IC 5-11-1-27(b) – SBOA must define the term "material" (subject to the approval of the audit committee) as it relates to erroneous or irregular variances, losses, shortages, or thefts of political subdivision funds or property.
- B. IC 5-11-1-27(f) – SBOA must develop or designate approved personnel training materials (subject to the approval of the audit committee) regarding internal control standards and procedures.
- C. IC 5-11-1-27(e) – SBOA must define (subject to the approval of the audit committee) the acceptable minimum level of internal control standards and procedures for internal control systems of political subdivisions, including the following: (1) control environment, (2) risk assessment, (3) control activities, (4) information and communication, and (5) monitoring.
- D. IC 5-11-1-27(h) – SBOA must receive certifications from the fiscal officers of political subdivisions via Gateway that: (1) the minimum internal control standards and procedures defined have been adopted by the political subdivision; and (2) personnel have received required training.
- E. IC 5-11-1-27(i) – SBOA must issue a comment in the examination report of a political subdivision if (1) the political subdivision has not adopted the required internal control standards and procedures, or (2) personnel of the political subdivision have not received the required training. And if, during a subsequent audit, the violation noted in the examination report has not been corrected and the political subdivision does not correct the violation within another 60 days, SBOA must forward such information to the DLGF.
- F. IC 5-11-1-28 – SBOA must designate an examiner to (a) receive internal audit reports and reviews from internal auditors of BMV, FSSA, and DOR; and (b) compile a final report of the results of the internal audits and, by September 1, 2015, submit a copy of the final report to (A) the governor, (B) the auditor of state, (C) the chairperson of the audit committee in an electronic format under IC 5-14-6, (D) the director of OMB, and (E) the legislative council, in an electronic format under IC 5-14-6.

4. House Enrolled Act 1485

- A. IC 6-3.6-10-7(d) – SBOA must annually audit regional venture capital funds. The fund bears the full costs of the audit.
- B. IC 6-3.6-10-8(c) – SBOA must annually audit local venture capital funds. The fund bears the full costs of the audit.

5. Senate Enrolled Act 330

IC 36-4-3-11.2(d) – SBOA must design remonstrance forms to be used solely in the section 11.2 remonstrance process, and provide the forms to the county auditor in an electronic format that permits the county auditor to copy or reproduce the forms using the county auditor's own equipment or a commercial copying service.

6. Senate Enrolled Act 393

- A. IC 5-4-1-5.1(e) – SBOA must receive copies of official bonds from the fiscal officers of political subdivisions via Gateway.
- B. IC 5-4-1-5.1(f) – SBOA must maintain a database of bonds received and make the data base available to the public on the state board of accounts web site. To the extent practicable, the database must include a list that specifies: (1) every individual who is required to file an official bond, and (2) whether each individual specified has obtained and filed an official bond.

7. Senate Enrolled Act 394

IC 5-11-1-9.5 – An individual may report suspected malfeasance, misfeasance, or nonfeasance by a public officer to SBOA. The individual's identity is confidential unless a civil proceeding is pending under IC 5-11-5-1(a) and the court orders disclosure.

8. Senate Enrolled Act 436

IC 6-1.1-36-18(d) – Upon request of a fiscal body, SBOA and DLGF shall provide assistance to the body in prescribing a uniform property tax disclosure form required under section 18.

9. Senate Enrolled Act 489

- A. IC 5-11-1-28.2 – SBOA has regular access to any statement of condition filed by a depository with the treasurer of state.
- B. IC 5-11-1-29 – SBOA has read-only, electronic access to all vendor software and records of computer services that a vendor has supplied to a political subdivision.

Indiana State Board of Accounts

Strategic Optimization Assessment

Summary of Preliminary Results

October 22, 2015

FOR DISTRIBUTION TO:

LEGISLATIVE COUNCIL AUDIT AND FINANCIAL REPORTING SUBCOMMITTEE



BACKGROUND: TIMELINE

- In April 2014, the Indiana State Board of Accounts (SBOA), under the leadership of State Examiner Paul Joyce, implemented significant changes to SBOA's organizational structure.
- These changes reorganized the SBOA into two divisions: one to conduct audits, and one to conduct exams.
- Divisions were distributed throughout the state in a redesigned office structure that placed field examiners in one of four quadrant offices. Audit Coordinators now schedule personnel and work with Audit Managers to assign and deploy field examiners to audits. Audit Managers are responsible for reviewing Audit Teams' progress and providing feedback to Audit Coordinators.



BACKGROUND: TIMELINE

- In January 2015, the Indiana State Legislature enacted changes to SBOA's statutory requirements and funding structure.
- These legislative changes raised the daily audit rate that SBOA charges government units from \$45 per day to \$175 per day and permitted SBOA to raise the starting salary for Field Examiners.
- The additional available revenues and salaries have enabled SBOA to increase staff, which had been previously reduced as a result of several years of state-level budget cuts. As of September 2015, SBOA had approximately 230 staff.
- The increased staff size will enable SBOA to **effectively** address the large backlog of audits that have resulted from a legacy of resource challenges.



BACKGROUND: INTEGRATED, RISK-BASED FRAMEWORK

- The legislative changes also enable SBOA to schedule and conduct audits leveraging an *integrated, risk-based* audit framework.
- Previously, SBOA had been required to conduct an audit of every government unit on an annual or biannual basis, regardless of the attendant risk profile. The risk-based framework has enabled SBOA to develop a schedule that prioritizes audits based on the level of financial and regulatory risk that the government unit represents to the State of Indiana. The framework is being integrated into and across all levels and departments of SBOA.
- This framework further enables SBOA to remain *independent* and *objective* in its work and approach, and improves the overall *effectiveness* and *efficiency* of SBOA audit and examination processes (in accordance with IC 2-5-1.1-6.3.c.1).



BACKGROUND: DIVISION OF SPECIAL INVESTIGATIONS

- Recent assumption of fraud investigative powers and responsibilities
- SBOA's subpoena powers enable it to participate as an equal in special investigations
- Partnership with FBI to conduct evidence gathering and investigation of suspects – confessions gathered by the Director of Special Investigations are hearsay
- Development of reports on fraudulent activity for pursuit of a charge – “distilment” of the larger audit report into a brief that summarizes the wrongdoing
- Audit Coordinators have the experience they need to identify fraudulent activity and bring the matter to the attention of the Director of Special Investigations
- State Police/FBI can request SBOA to conduct an audit of an entity if they receive a tip regarding fraudulent activity
- Position further enhances SBOA's conduct of *effective, objective, and independent* audits and examinations



STRATEGIC OPTIMIZATION ASSESSMENT

- In June 2015, SBOA engaged Bronner Group, LLC, (BRONNER) to conduct a *Strategic Optimization Assessment* (Assessment) of the organization.
- The objective of BRONNER'S Assessment was to review SBOA's organizational and operational framework and to identify recommendations for enhancing its operating framework and efficiency.



STRATEGIC OPTIMIZATION ASSESSMENT: METHODOLOGY

To conduct its Assessment, BRONNER performed a broad-based review of SBOA's organization and operations. This review focused on SBOA's current organizational structure, policies, and procedures and engaged the full spectrum of SBOA staff.

The specific, high-level tasks of the Assessment included:

1. Evaluating SBOA's organizational and legislative framework
2. Analyzing SBOA's roles and responsibilities in light of this framework
3. Identifying opportunities to enhance the framework's efficiency and effectiveness
4. Developing an implementation plan to enhance organization and operations to better achieve SBOA's mission

STRATEGIC OPTIMIZATION ASSESSMENT: METHODOLOGY

BENCHMARKING

BRONNER identified four audit agencies from across the country to examine based on substantial similarities in staff size, organizational structure, statutory authority, and budget appropriation. Based on these criteria, BRONNER established best practices in organizational and operational structures among state audit offices and determined how SBOA compared to its national peers based on these metrics.

INTERVIEWS

BRONNER conducted interviews with SBOA leadership, department directors, audit and exam coordinators, and a sample of audit managers. In each interview, BRONNER consultants asked the SBOA staff member to identify areas in which SBOA is effectively meeting its mission, areas in which it is not meeting its mission, and actions that SBOA should take to improve its performance.



STRATEGIC OPTIMIZATION ASSESSMENT: METHODOLOGY

DOCUMENTATION REVIEW

BRONNER reviewed documentation on internal SBOA policies and procedures as well as public-facing documents related to SBOA statutory requirements; SBOA organizational and operational processes; and standards for audit planning, scheduling, and report review.

ANNUAL MEETING, OPEN FORUM, AND STAFF SURVEYS

BRONNER attended SBOA's Annual Meeting in September 2015 to present the purpose, methodology, and initial findings of the Strategic Optimization Assessment, and to conduct an open forum with SBOA staff. This forum allowed staff to provide feedback on BRONNER's initial findings. BRONNER asked SBOA staff to complete an anonymous, paper-based survey consisting of 14 statements on communication, oversight, and training. BRONNER consultants received 144 surveys and tabulated the results.



ELEMENTS OF ENTERPRISE EFFECTIVENESS

BRONNER's Assessment analyzed SBOA within the context of the following Elements of Enterprise Effectiveness:

Internal Control	The set of fiscal and administrative practices, policies, and procedures used by SBOA to provide reasonable assurance that it is achieving its goals, objectives, and statutory duties.
Performance	Actions taken that impact upon SBOA's ability to perform as expected and achieve set goals and objectives through its services. Proper organizational alignment and integration of functions directly impacts the ability to perform optimally.
Communication	The tools, techniques, and methods used to share information with internal and external stakeholders of SBOA.
Accountability	The processes and procedures used by SBOA to act visibly, predictably, and independently regarding the conduct of its business affairs. This entails having clear roles, responsibilities, and procedures for making decisions; and managing information for relevance, accessibility, and accuracy.
Transparency	The framework used to ensure that SBOA officials and employees are answerable for their actions and that there is redress when duties and commitments are not met.



PRELIMINARY OBSERVATIONS

- Enterprise-wide recognition of strategic direction
 - Staff share leadership's vision for SBOA
- Effective implementation of reorganization plan
 - Audit team resources are being deployed to audits more effectively
- Special Investigations promotes partnership with law enforcement
 - Special Investigations Division leverages audit expertise in law enforcement's fraud investigations
- Strategic implementation of risk-based audit planning
 - Audit planning focuses on high-risk audits
- Need for independence of entities and programs under audit purview
 - SBOA must be afforded independence, in appearance and in fact, in accordance with professional standards
 - SBOA staff recognizes and embraces need for objectivity and independence to facilitate and sustain appropriate levels of accountability



IDENTIFIED ENTERPRISE OPPORTUNITIES: INTEGRATION AND RISK-MANAGEMENT

Ensuring increased levels of organization-wide *integration* and *risk-management* at the enterprise level will support the achievement of SBOA's mission and statutory authority.

Elements of Enterprise Effectiveness

- Internal control
- Performance
- Communication
- Accountability
- Transparency

Integration

- Quality Assurance
- Top-level and SBOA-wide Perspectives
- Interdepartmental Connectivity
- Leadership-driven, Cross-agency Monitoring
- Seamless System

Risk-Management

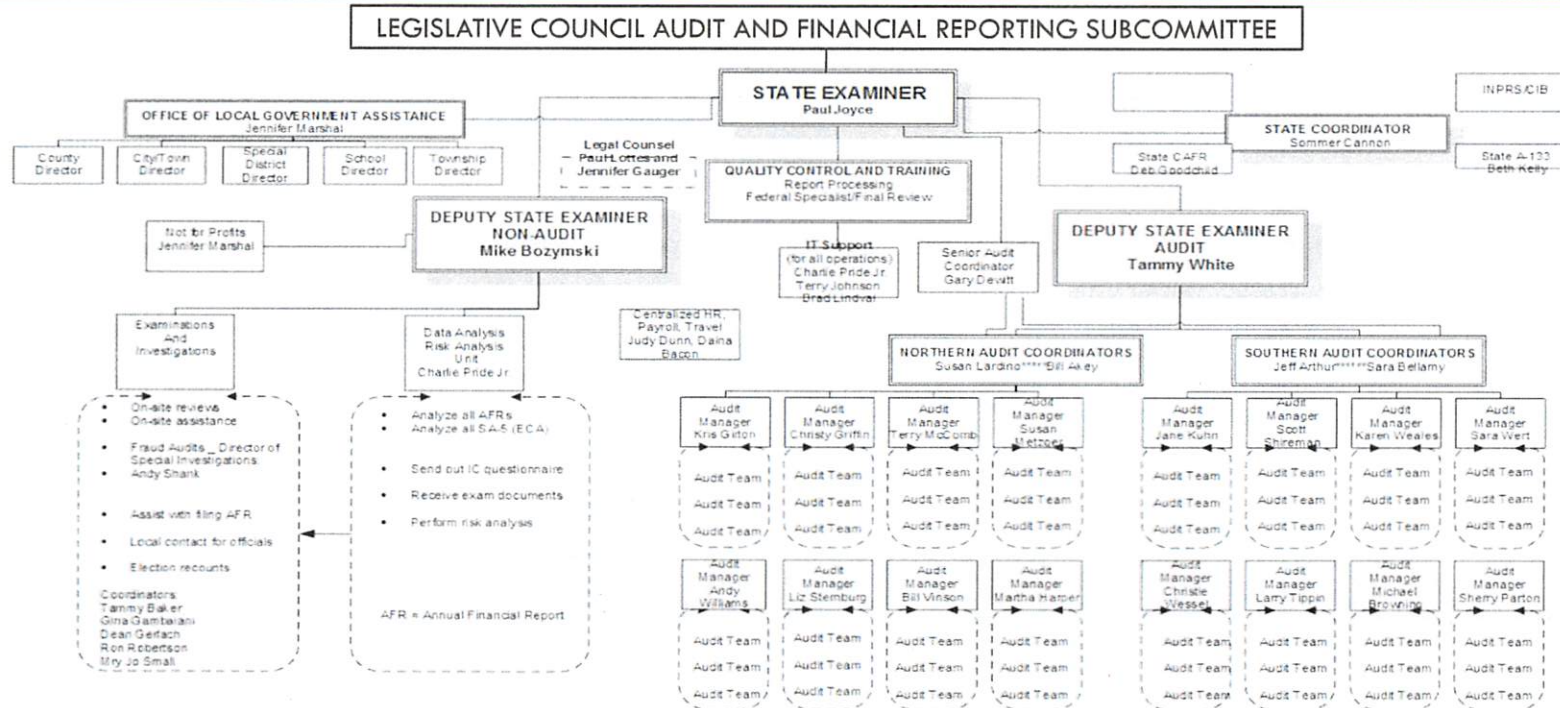
- Agency-level Initiative
- Driver of Agency Excellence
- Comprehensive Approach
- Independence
- Safeguard of Public Trust

IDENTIFIED OPPORTUNITIES FOR CONTINUED SUCCESS

- *Developing a centralized knowledge management system*
 - Enhances understanding of professional standards and regulatory requirements in a cost-effective and accessible manner
 - Supports the development of a comprehensive program for staff training and professional development
- *Promoting enterprise-wide culture of risk management*
 - Establishes a “tone-at-the-top” to ensure enterprise-wide coordination on SBOA priorities and statutory requirements
 - Ensures understanding of and compliance with existing guidelines and professional standards
- *Creating an Office of Audit Standards and Planning*
 - Provides a continual source of evaluation and improvement for audit processes
 - Provides for the development of enterprise-wide communication protocols regarding professional standards awareness and application



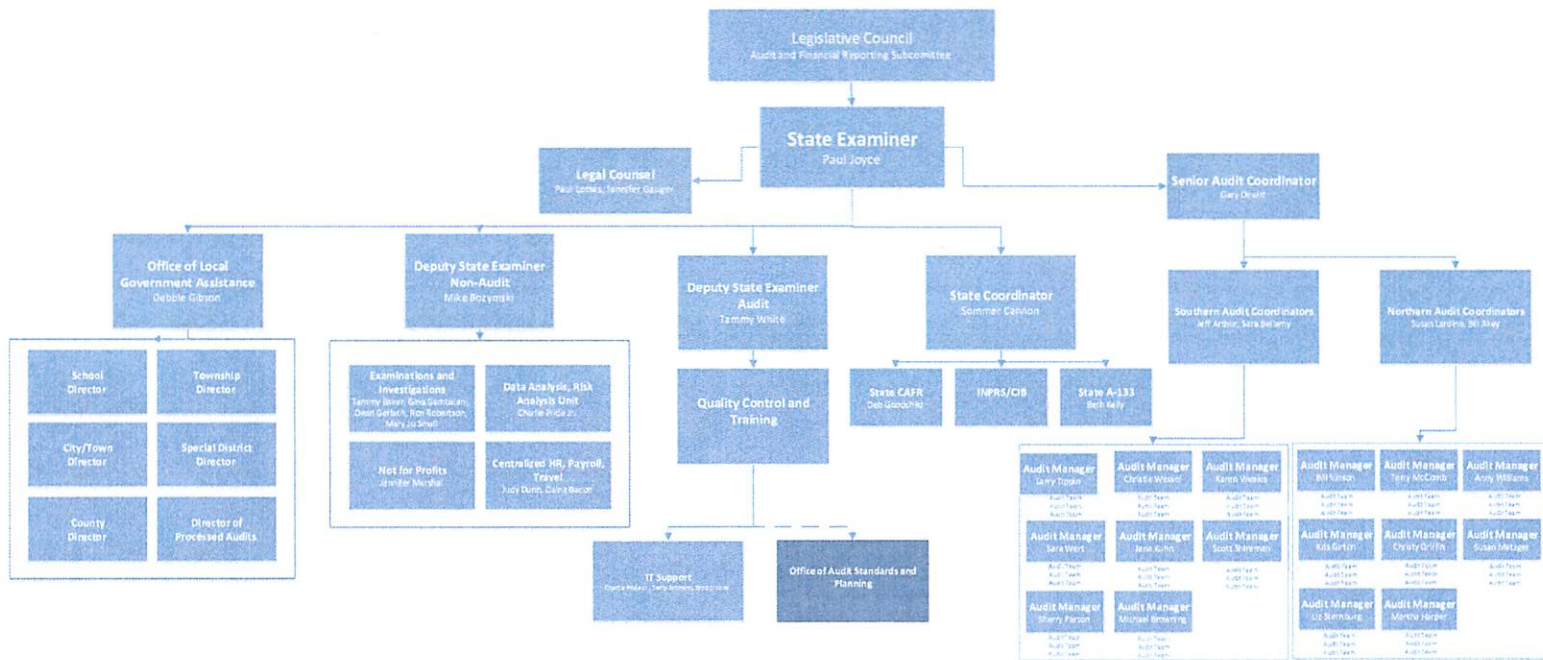
CURRENT ORGANIZATIONAL STRUCTURE



STATE BOARD OF ACCOUNTS ORGANIZATIONAL CHART



RECOMMENDED ORGANIZATIONAL STRUCTURE WITH OFFICE OF STANDARDS AND PLANNING



NEXT STEPS

To facilitate the implementation of the Strategic Optimization Assessment recommendations, BRONNER has proposed the following next steps for SBOA:

I. Complete Strategic Optimization Assessment

II. Convene Strategic Optimization Implementation Planning Session

III. Convene Audit Planning Focus Groups

IV. Establish a Strategic Optimization Implementation Committee (STOIC)

V. Assign Accountability & Timeframe for Implementation

VI. Establish Performance Monitoring Framework

December 2011

Government Auditing Standards

2011 Revision



considered independent as an external audit organization of those external parties.

Provision of
Nonaudit Services to
Audited Entities

3.33 Auditors have traditionally provided a range of nonaudit services that are consistent with their skills and expertise to entities at which they perform audits. Providing such nonaudit services may create threats to an auditor's independence.

Requirements for
Performing Nonaudit
Services

3.34 Before an auditor agrees to provide a nonaudit service to an audited entity, the auditor should determine whether providing such a service would create a threat to independence, either by itself or in aggregate with other nonaudit services provided, with respect to any GAGAS audit it performs. A critical component of this determination is consideration of management's ability to effectively oversee the nonaudit service to be performed. The auditor should determine that the audited entity has designated an individual who possesses suitable skill, knowledge, or experience, and that the individual understands the services to be performed sufficiently to oversee them. The individual is not required to possess the expertise to perform or reperform the services. The auditor should document consideration of management's ability to effectively oversee nonaudit services to be performed.

3.35 If an auditor were to assume management responsibilities for an audited entity, the management participation threats created would be so significant that no safeguards could reduce them to an acceptable level. Management responsibilities involve leading and directing an entity, including making decisions regarding the acquisition, deployment and control of human, financial, physical, and intangible resources.

3.36 Whether an activity is a management responsibility depends on the facts and circumstances and auditors

exercise professional judgment in identifying these activities. Examples of activities that are considered management responsibilities and would therefore impair independence if performed for an audited entity include:

- a.** setting policies and strategic direction for the audited entity;
- b.** directing and accepting responsibility for the actions of the audited entity's employees in the performance of their routine, recurring activities;
- c.** having custody of an audited entity's assets;
- d.** reporting to those charged with governance on behalf of management;
- e.** deciding which of the auditor's or outside third party's recommendations to implement;
- f.** accepting responsibility for the management of an audited entity's project;
- g.** accepting responsibility for designing, implementing, or maintaining internal control;
- h.** providing services that are intended to be used as management's primary basis for making decisions that are significant to the subject matter of the audit;
- i.** developing an audited entity's performance measurement system when that system is material or significant to the subject matter of the audit; and
- j.** serving as a voting member of an audited entity's management committee or board of directors.

3.37 Auditors performing nonaudit services for entities for which they perform audits should obtain assurance that audited entity management performs the following functions in connection with the nonaudit services:

- a. assumes all management responsibilities;
- b. oversees the services, by designating an individual, preferably within senior management, who possess suitable skill, knowledge, or experience;³²
- c. evaluates the adequacy and results of the services performed; and
- d. accepts responsibility for the results of the services.

3.38 In cases where the audited entity is unable or unwilling to assume these responsibilities (for example, the audited entity does not have an individual with suitable skill, knowledge, or experience to oversee the nonaudit services provided, or is unwilling to perform such functions due to lack of time or desire), the auditor's provision of these services would impair independence.

3.39 In connection with nonaudit services, auditors should establish and document their understanding with the audited entity's management or those charged with governance, as appropriate, regarding the following:

- a. objectives of the nonaudit service;
- b. services to be performed;
- c. audited entity's acceptance of its responsibilities;

³²See paragraph 3.34 for additional discussion of management's ability to effectively oversee the nonaudit service.

- d.** the auditor's responsibilities; and
- e.** any limitations of the nonaudit service.

3.40 Routine activities performed by auditors that relate directly to the performance of an audit, such as providing advice and responding to questions as part of an audit, are not considered nonaudit services under GAGAS. Such routine activities generally involve providing advice or assistance to the entity on an informal basis as part of an audit. Routine activities typically are insignificant in terms of time incurred or resources expended and generally do not result in a specific project or engagement or in the auditors producing a formal report or other formal work product. However, activities such as financial statement preparation, cash to accrual conversions, and reconciliations are considered nonaudit services under GAGAS, not routine activities related to the performance of an audit, and are evaluated using the conceptual framework as discussed in paragraph 3.46.

3.41 Routine activities directly related to an audit include the following:

- a.** providing advice to the audited entity on an accounting matter as an ancillary part of the overall financial audit;
- b.** researching and responding to the audited entity's technical questions on relevant tax laws as an ancillary part of providing tax services;
- c.** providing advice to the audited entity on routine business matters;
- d.** educating the audited entity on matters within the technical expertise of the auditors; and

e. providing information to the audited entity that is readily available to the auditors, such as best practices and benchmarking studies.

3.42 An auditor who previously performed nonaudit services for an entity that is a prospective subject of an audit should evaluate the impact of those nonaudit services on independence before accepting an audit. If the nonaudit services were performed in the period to be covered by the audit, the auditor should (1) determine if the nonaudit service is expressly prohibited by GAGAS and, if not, (2) determine whether a threat to independence exists and address any threats noted in accordance with the conceptual framework.

3.43 Nonaudit services provided by auditors can impact independence of mind and in appearance in periods subsequent to the period in which the nonaudit service was provided. For example, if auditors have designed and implemented an accounting and financial reporting system that is expected to be in place for many years, a threat to independence in appearance for future financial audits or attestation engagements performed by those auditors may exist in subsequent periods. For recurring audits, having another independent audit organization perform an audit of the areas affected by the nonaudit service may provide a safeguard that allows the audit organization that provided the nonaudit service to mitigate the threat to its independence. Auditors use professional judgment to determine whether the safeguards adequately mitigate the threats.

3.44 An auditor in a government entity may be required to perform a nonaudit service that could impair the auditor's independence with respect to a required audit. If the auditor cannot, as a consequence of constitutional or statutory requirements over which the auditor has no control, implement safeguards to reduce the resulting

threat to an acceptable level, or decline to perform or terminate a nonaudit service that is incompatible with audit responsibilities, the auditor should disclose the nature of the threat that could not be eliminated or reduced to an acceptable level and modify the GAGAS compliance statement accordingly.³³

Consideration of Specific Nonaudit Services

3.45 By their nature, certain nonaudit services directly support the entity's operations and impair auditors' ability to maintain independence in mind and appearance. The nonaudit services discussed below are among those frequently requested of auditors working in a government environment. Some aspects of these services will impair an auditor's ability to perform audits for the entities for which the services are provided. The specific services indicated are not the only nonaudit services that would impair an auditor's independence.

3.46 Auditors may be able to provide nonaudit services in the broad areas indicated in paragraphs 3.49 through 3.58 without impairing independence if (1) the nonaudit services are not expressly prohibited, (2) the auditor has determined that the requirements for performing nonaudit services in paragraphs 3.34 through 3.44 have been met, and (3) any significant threats to independence have been eliminated or reduced to an acceptable level through the application of safeguards. Auditors should use the conceptual framework to evaluate independence given the facts and circumstances of individual services not specifically prohibited in this section.

3.47 For performance audits and agreed-upon procedures engagements, nonaudit services that are

³³See paragraphs 2.24 and 2.25 for the discussion of modifications to the GAGAS compliance statement.

otherwise prohibited by GAGAS may be provided when such services do not relate to the specific subject matter of the engagement.

3.48 For financial statement audits and examination or review engagements, a nonaudit service performed during the period covered by the financial statements may not impair an auditor's independence with respect to those financial statements provided that the following conditions exist:

- a.** the nonaudit service was provided prior to the period of professional engagement;
- b.** the nonaudit service related only to periods prior to the period covered by the financial statements; and
- c.** the financial statements for the period to which the nonaudit service did relate were audited by another auditor (or in the case of an examination or review engagement, examined, reviewed, or audited by another auditor as appropriate).

**Management
Responsibilities**

3.49 If performed on behalf of an audited entity by the entity's auditor, management responsibilities such as those listed in paragraph 3.36 would create management participation threats so significant that no safeguards could reduce them to an acceptable level. Consequently the auditor's independence would be impaired with respect to that entity.

**Preparing Accounting
Records and Financial
Statements**

3.50 Some services involving preparation of accounting records always impair an auditor's independence with respect to an audited entity. These services include:

- a.** determining or changing journal entries, account codes or classifications for transactions, or other accounting records for the entity without obtaining management's approval;

b. authorizing or approving the entity's transactions;
and

c. preparing or making changes to source documents without management approval. Source documents include those providing evidence that transactions have occurred (for example, purchase orders, payroll time records, customer orders, and contracts). Such records also include an audited entity's general ledger and subsidiary records or equivalent.

3.51 Management is responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework, even if the auditor assisted in drafting those financial statements. Consequently, an auditor's acceptance of responsibility for the preparation and fair presentation of financial statements that the auditor will subsequently audit would impair the auditor's independence.

3.52 Services related to preparing accounting records and financial statements that an auditor may be able to provide to an audited entity if the conditions in paragraph 3.46 are met include:

a. recording transactions for which management has determined or approved the appropriate account classification, or posting coded transactions to an audited entity's general ledger;

b. preparing financial statements based on information in the trial balance;

c. posting entries that have been approved by an audited entity's management to the entity's trial balance;

d. preparing account reconciliations that identify reconciling items for the audited entity management's evaluation; and

e. proposing standard, adjusting, or correcting journal entries or other changes affecting the financial statements to an audited entity's management provided management reviews and accepts the entries and the auditor is satisfied that management understands the nature of the proposed entries and the impact the entries have on the financial statements.

**Internal Audit
Assistance Services
Provided by External
Auditors**

3.53 Internal audit assistance services involve assisting an entity in the performance of its internal audit activities. Certain internal audit assistance activities always impair an external auditor's independence with respect to an audited entity. These activities include:

a. setting internal audit policies or the strategic direction of internal audit activities;

b. performing procedures that form part of the internal control, such as reviewing and approving changes to employee data access privileges; and

c. determining the scope of the internal audit function and resulting work.

**Internal Control
Monitoring as a
Nonaudit Service**

3.54 Accepting responsibility for designing, implementing or maintaining internal control includes accepting responsibility for designing, implementing, or maintaining monitoring procedures.³⁴ Monitoring involves the use of either ongoing monitoring procedures or separate evaluations to gather and analyze persuasive information supporting conclusions about the effectiveness of the internal control system.

³⁴See A.03 and A.04 for a discussion of internal control.

Ongoing monitoring procedures performed on behalf of management are built into the routine, recurring operating activities of an organization. Therefore, the management participation threat created if an auditor performs or supervises ongoing monitoring procedures is so significant that no safeguards could reduce the threat to an acceptable level.

3.55 Separate evaluations are sometimes performed as nonaudit services by individuals who are not directly involved in the operation of the controls being monitored. As such, it is possible for an auditor to provide an objective analysis of control effectiveness by performing separate evaluations without creating a management participation threat that would impair independence. However, in all such cases, the significance of the threat created by performing separate evaluations should be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. Auditors should assess the frequency of the separate evaluations as well as the scope or extent of the controls (in relation to the scope of the audit performed) being tested when evaluating the significance of the threat. An evaluation prepared as a nonaudit service is not a substitute for audit procedures in a GAGAS audit.

Information
Technology Systems
Services

3.56 Services related to information technology (IT) systems include the design or implementation of hardware or software systems. The systems may aggregate source data, form part of the internal control over the subject matter of the audit, or generate information that affects the subject matter of the audit. IT services that would impair independence if provided by an audit organization to an audited entity include:

a. designing or developing a financial or other IT system that will play a significant role in the management of an

area of operations that is or will be the subject matter of an audit;

b. providing services that entail making other than insignificant modifications to the source code underlying such a system; and

c. operating or supervising the operation of such a system.

Valuation Services

3.57 A valuation comprises the making of assumptions with regard to future developments, the application of appropriate methodologies and techniques, and the combination of both to compute a certain value, or range of values, for an asset, a liability, or an entity as a whole. If an audit organization provides valuation services to an audited entity and the valuations would have a material effect, separately or in the aggregate, on the financial statements or other information on which it is reporting, and the valuation involves a significant degree of subjectivity, the audit organization's independence would be impaired.

Other Nonaudit Services

3.58 Provision of certain other nonaudit services always impairs an external auditor's independence with respect to an audited entity. These activities include:

a. Non tax disbursement – prohibited nonaudit services

(1) Accepting responsibility to authorize payment of audited entity funds, electronically or otherwise.

(2) Accepting responsibility for signing or cosigning audited entity checks, even if only in emergency situations.

(3) Maintaining an audited entity's bank account or otherwise having custody of an audited entity's funds or

making credit or banking decisions for the audited entity.

(4) Approving vendor invoices for payment.

b. Benefit plan administration – prohibited nonaudit services

(1) Making policy decisions on behalf of audited entity management.

(2) When dealing with plan participants, interpreting the plan document on behalf of management without first obtaining management's concurrence.

(3) Making disbursements on behalf of the plan.

(4) Having custody of a plan's assets.

(5) Serving a plan as a fiduciary as defined by the Employee Retirement Income Security Act (ERISA).

c. Investment—advisory or management—prohibited nonaudit services

(1) Making investment decisions on behalf of audited entity management or otherwise having discretionary authority over an audited entity's investments.

(2) Executing a transaction to buy or sell an audited entity's investment.

(3) Having custody of an audited entity's assets, such as taking temporary possession of securities purchased by an audited entity.

d. Corporate finance—consulting or advisory – prohibited nonaudit services

(1) Committing the audited entity to the terms of a transaction or consummating a transaction on behalf of the audited entity.

(2) Acting as a promoter, underwriter, broker-dealer, or guarantor of audited entity securities, or distributor of private placement memoranda or offering documents.

(3) Maintaining custody of an audited entity's securities.

e. Executive or employee personnel matters – prohibited nonaudit services

(1) Committing the audited entity to employee compensation or benefit arrangements.

(2) Hiring or terminating audited entity employees.

f. Business risk consulting – prohibited nonaudit services

(1) Making or approving business risk decisions.

(2) Presenting business risk considerations to those charged with governance or others on behalf of management.

Documentation

3.59 Documentation of independence considerations provides evidence of the auditor's judgments in forming conclusions regarding compliance with independence requirements. GAGAS contains specific requirements for documentation related to independence which may be in addition to the documentation that auditors have previously maintained. While insufficient documentation of an auditor's compliance with the independence standard does not impair independence, appropriate documentation is required under the GAGAS quality

Audit Findings Not Corrected

The Joint Legislative Auditing Committee (Committee) has the authority to enforce certain provisions of law against educational and local governmental entities that have failed to correct audit findings reported in three successive audit reports. In accordance with ss. 11.45(7)(i)¹ and 218.39(8)² F.S., the Auditor General is required to notify the Committee when an audit report of a state university, Florida College System institution, school district, charter school, charter technical career center, county, municipality, or special district indicates that the entity has failed to correct these findings.

Initially, the Committee may request a written statement from the entity to obtain a status update. If a finding has not been corrected, the entity will be requested to explain: (1) why corrective action has not been taken, and (2) the details of any corrective action planned.

If the Committee determines that the statement provided is not sufficient, it may require an official of the entity to appear before the Committee to discuss the finding(s). If, after the official's appearance and explanation, the Committee is still not satisfied with the entity's effort to correct the audit finding(s), it may proceed with the provisions of ss. 11.40(2) or 11.45(7), F.S., which authorize the following actions:

Type of Entity	Applicable Florida Statute	Action Authorized
Charter School or Charter Technical Career Center	<u>11.40(2)(c)</u>	Notify the appropriate sponsoring entity which may terminate the school's charter.
District School Board	<u>11.40(2)(a)</u>	Direct the Department of Financial Services and the Department of Revenue to withhold selected state revenue.
State University	<u>11.45(7)(i)</u>	Refer the university to the Board of Governors to proceed in accordance with <u>s. 1008.322, F.S.</u>
Florida College System Institution	<u>11.45(7)(i)</u>	Refer the college to the State Board of Education to proceed in accordance with <u>s. 1008.32, F.S.</u>
County	<u>11.40(2)(a)</u>	Direct the Department of Financial Services and the Department of Revenue to withhold selected state revenue.
Municipality	<u>11.40(2)(a)</u>	Direct the Department of Financial Services and the Department of Revenue to withhold

		selected state revenue.
Special District	<u>11.40(2)(b)</u>	Direct the Department of Economic Opportunity to proceed with <u>s. 189.062, F.S.</u> (to declare the district inactive) or <u>s. 189.067, F.S.</u> (to take legal action); public hearings are authorized for certain special districts in accordance with <u>s. 189.034(3)</u> , and <u>s. 189.035(3), F.S.</u>

¹Chapter 2012-134, *Laws of Florida*.

²Chapter 2011-144, *Laws of Florida*.

What is the status of implementation of these laws (ss. 11.45(7)(j) and 218.39(8), F.S.)?

The Committee received the third series of notifications from the Auditor General in late 2014. The notifications were based on the Auditor General's review of 2012-13 fiscal year audit reports.

The following is a breakdown of the number of entities, by type, with one or more audit findings included in the 2012-13 fiscal year audit report that were also included in the two previous audit reports. These were reported to the Committee by February 2015:

Type of Entity	Number with Repeat Audit Findings	Total Number of Repeat Findings
Charter School or Charter Technical Career Center	23	34
District School Board	43	114
State University	4	5
Florida College System Institution	6	6
County Office (Board of County Commissioners, Clerk of Circuit Court, Property Appraiser, Supervisor of Elections, Sheriff, and Tax Collector)	84	150
Municipality	144	360

Special District	154	258
Total	458	927

On February 16, 2015, the Committee took action to request a written statement from most of the entities included on the notifications from the Auditor General. See the Committee's meeting packet for the specific entities (February 16, 2015; beginning on page 242 of 546). The Committee approved the recommendations included in the meeting packet.

How are the entities notified that a written response is required?

A hard copy of a letter from the Committee's Chairs will be sent by U.S. mail to the top elected or appointed official of each entity. Also, an electronic copy of this letter will be sent to the same individual and appropriate staff members or other individuals as follows:

Type of Entity	Hard and Electronic Copy Recipient	Electronic Copy Recipient
Charter School or Charter Technical Career Center	Directors	School Board; Adam Emerson, Charter Schools Director at the Department of Education (DOE)
District School Board	Chair of the District School Board (DSB)	Superintendent of Schools; Finance Director or equivalent of DSB; Suzanne Tart, Bureau Chief, School Business Services at DOE
Florida College System Institution	Chair of the College's Board of Trustees	President of College; Vice President of Finance, Administrative Services, or equivalent; Scott Kittel, Associate Vice Chancellor for Fiscal Policy, DOE
State University	Chair of University's Board of Trustees	President of University; CFO, Vice President of Financial Affairs, or equivalent; Tim Jones, CFO, Board of Governors; Joseph Maleszewski, Inspector

		General, Board of Governors
County Office	Chair of Board of County Commissioners (BCC), Clerk of Circuit Court, Property Appraiser, Sheriff, Supervisor of Elections, or Tax Collector, as appropriate	BCC letters: County manager or administrator; Finance Director or equivalent Other County Constitutional Officers: electronic copies were not sent
Municipality	Mayor or equivalent	City manager or administrator; CFO, Finance Director, or Clerk
Special District	Generally sent to the Chair of the Governing Board. In some cases the District recommended another individual, such as the Controller or District Accountant, to be the recipient.	Electronic copies were sent to individuals for most districts, but not all. Recipients included: Registered Agent, Executive Director or similar staff, and finance staff.

A response deadline will be provided in the letter. Any entity that fails to provide a written response will likely be considered by the Committee to be required to appear before the Committee to: (1) explain its failure to respond, and (2) provide the status of its action to correct the relevant audit finding(s).

Where should we send our response?

You may respond by email, fax, or mail as follows:

Email: jlac@leg.state.fl.us

Fax: 850-922-5667

Mail: Honorable Joseph Abruzzo,
Chair
Joint Legislative Auditing
Committee
111 West Madison St., Rm. 876
Tallahassee, FL 32399-1400

If we send a written response by email or fax, should we also send a hard copy response by U.S. mail or another carrier?

No, it is not necessary. We only require one response. When we receive an email response, we will reply to you that it has been received. If you do not receive an acknowledgement, you may wish to phone our office (850-487-4110) to verify that we have received your email. If you send by fax or U.S. mail, you may wish to request that we acknowledge receipt. If so, please provide an email address or phone number of the person we should contact.

How can electronic copies of audit reports be accessed?

Audit reports are available on the Auditor General's website as follows:

- **Audits conducted by the Auditor General**
(includes audits of all State Universities and Florida College System Institutions, many District School Boards, some County Offices, Municipalities and Special Districts)
 - Begin on the Auditor General's website (www.myflorida.com/audgen);
 - In the left column, under the heading '**Auditor General Released Reports**' hover over by 'Entity Audited;'
 - Select the type of entity (District School Boards, Colleges, Universities, or Local Government / Nonprofit); and
 - Select the entity and type of audit report. [Note: The findings reported to the Committee pursuant to ss. 11.45(7)(j) and 218.39(8), F.S., are those included in either financial or operational audit reports. The findings included in other types of audit reports issued by the Auditor General, such as the Florida Education Finance Program audits, are not required to be reported.]

- **Audits conducted by private CPAs/CPA firms**
(includes audits of all Charter Schools, some District School Boards, most County Offices, Municipalities, and Special Districts)
 - Begin on the Auditor General's website (www.myflorida.com/audgen);
 - In the left column, under the heading '**Reports Filed with the Auditor General**' hover over by 'Filed Reports;'
 - Select the type of entity (Charter Schools and Centers, Counties, District School Boards, Municipalities, or Special Districts; Note: County audits contain the audits of all County Constitutional Officers); and
 - Select the entity and then the fiscal year.

What should we do if our entity has corrected the audit finding(s) since the audit period?

Please state in writing that the finding has been corrected. A brief email message is sufficient. Please ensure that you indicate the name of your entity and the finding number(s) that has been corrected. If

your next audit report has been released and it includes a statement by the auditor that the finding has been corrected, it would be helpful if you provide a copy of that page. Please do not submit your entire audit report to the Committee. Once available, Committee staff will review the audit report you are required submit to the Auditor General pursuant to s. 218.39, F.S., if applicable.

We provided a response to our audit finding(s) to our auditor and it was included in the audit report. Can we send a copy of it as our response?

No. Please expand on the response and provide the current status of any corrective action that you have taken or plan to take to address the finding(s). By the time you receive a letter from the Committee, generally a substantial period of time has passed since your audit report was issued.

Can our auditor provide the written statement to the Committee?

Yes. Many entities are consulting with their auditor before submitting a response. If you and your auditor make an arrangement for him or her to respond on your entity's behalf, that is acceptable.

We are a small entity and do not have the resources needed to hire additional staff in order to correct certain audit findings. What should we do?

We understand it may not be possible or cost effective to hire additional staff in order to correct certain audit findings, such as a lack of segregation of duties. Although resources may not be available to fully resolve an audit finding, there may be compensating controls that can be implemented to address findings more common in smaller entities. If you are in this situation, please ensure that your entity has reviewed and revised policies and procedures, as appropriate, to mitigate the risk associated with a limited number of staff handling financial transactions. For example, some small county offices have made arrangements for an individual in another county office to open the bank statements and perform the required reconciliations. Other entities have elected official(s) or citizen(s) perform a review of expenditures, journal entries, or other transaction documentation as a compensating control. You may wish to discuss options with your auditor. Your written response should include a brief description of the steps your entity is taking or is planning to take to reduce the risk that fraudulent activity could occur and not be detected in a timely manner.

What is the purpose of this law?

It is the Committee staff's understanding that this law stemmed from complaints from citizens and other stakeholders that certain governing officials were not addressing audit findings that they believe should have been corrected.

Who should we contact if we have further questions?

Send an email to jlac@leg.state.fl.us or call the Committee's office at 850-487-4110.

SPECIAL INVESTIGATION REPORTS RESULTING IN CHARGES GREATER THAN \$50,000
 REPORTS FILED SEPTEMBER 2014 THRU OCTOBER 2015

<u>UNIT</u>	<u>REPORT</u>	<u>CHARGE</u>	<u>AUDIT COST</u>	<u>TOTAL</u>	<u>DESCRIPTION</u>
TERRE HAUTE AIRPORT	B44190	\$ 55,217.52	\$ 31,360.80	\$ 86,578.32	PERSONAL EXPENSES
CENTER TWP-MARION CO.	B44484	\$ 343,541.08	\$ 54,978.41	\$ 398,519.49	UNAUTHORIZED CREDIT CARD PYMTS
WHITLEY CO. AUDITOR	B44746	\$ 105,746.83	\$ 27,666.24	\$ 133,413.07	UNAUTHORIZED CREDIT CARD PYMTS
TOWN OF FOWLER-UTILITIES	B44747	\$ 50,357.31	\$ 38,350.29	\$ 88,707.60	COLLECTIONS NOT DEPOSITED
OWEN CO. AUDITOR	B44822	\$ 436,409.44	\$ 99,844.85	\$ 536,254.29	UNAUTHORIZED CREDIT CARD PYMTS, ETC.
TOWN OF SPEEDWAY-FIRE	B45219	\$ 62,585.56	\$ 21,232.94	\$ 83,818.50	THEFT OF RECEIPTS, ETC.
WARSAW COMM. SCHOOLS	B45250	\$ 943,781.94	\$ 45,136.63	\$ 988,918.57	OVERBILLING FOR SUPPLIES/KICKBACKS
NORTHSIDE MIDDLE SCHOOL	B45289	\$ 113,913.89	\$ 20,440.35	\$ 134,354.24	ECA COLLECTIONS NOT DEPOSITED
CLARK CO. LANDFILL	B45307	\$ 179,811.00	\$ -	\$ 179,811.00	UNDERPAYMENT OF HOST FEE, DUP PYMT
CITY OF GARY- IT DEPT	B45440	\$ 1,367,559.19	\$ 29,818.90	\$ 1,397,378.09	THEFT OF EQUIPMENT
TOTAL		\$ 3,658,923.76	\$ 368,829.41	\$ 4,027,753.17	