

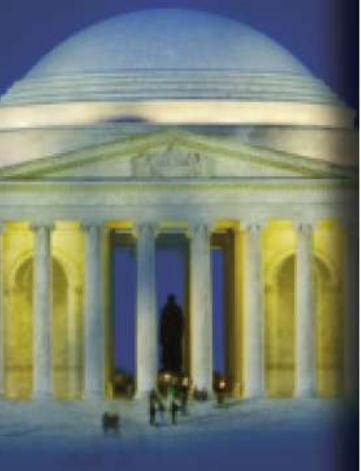
Stewardship, Internal Controls and Audit Readiness

Presented by

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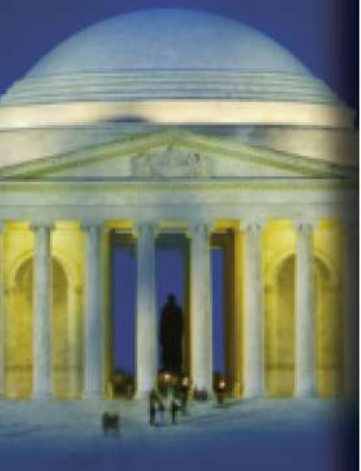
KEARNEY & COMPANY, P.C.

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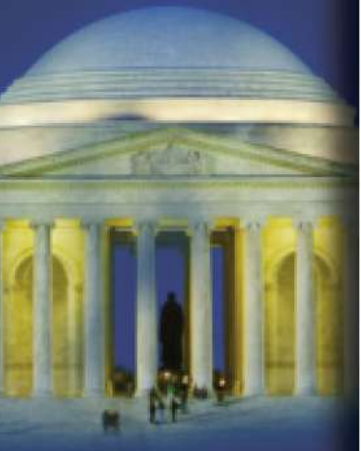


Agenda

- Stewardship
- Controls
- Audit Ready
- DC Tax Office—Lessons Learned
- Wrap-up and Discussion



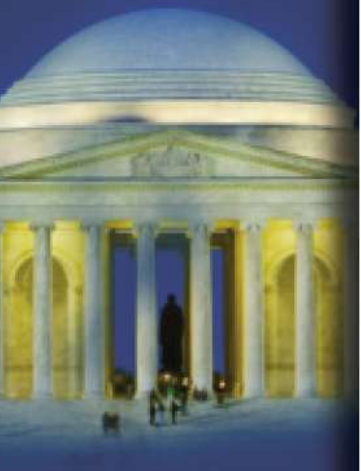
The Basics



Stewardship

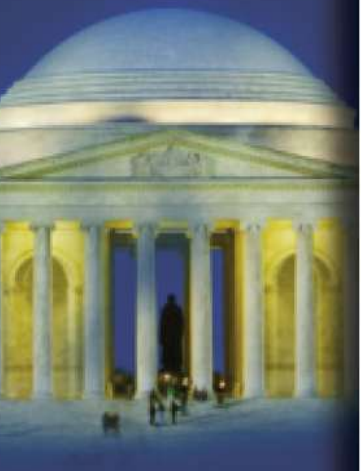
(Tone From The Top)

- Senior management needs to communicate stewardship objectives and ensure organizational commitment to the public trust
- More than slogans and bumper stickers—the organization needs a clear vision of what it is trying to achieve and objective methods to measure results
- Desired outcomes and results must be clearly communicated and transparent to the organization and the public
- Managers and employees must be held accountable for the responsible management and use of public resources in obtaining the organization's objectives



Stewardship (Tone From The Top)

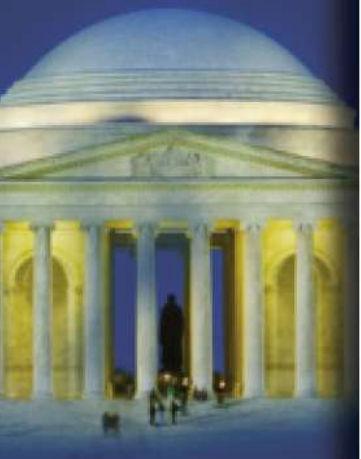
- Stewardship provides the foundation for setting objectives and outcome based indicators
- Outcome based indicators enable managers to:
 - Assess conditions and trends
 - Measure progress via financial improvement or corrective action plans
 - Enhance performance and accountability
 - Identify underperforming programs and make in-course corrections
 - Eliminate inefficiencies and redundancies impairing the effective management and use of public resources



“Controls designed and operating effectively provide reasonable assurance of the effectiveness and efficiency of operations, reliability of financial reporting, and compliance with laws and regulations.”

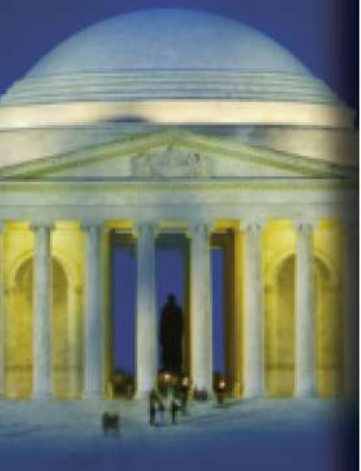


***Controls?* In a knife fight? No *controls!*
Well, if there aint' going to be any *controls*, let's get the fight started.**

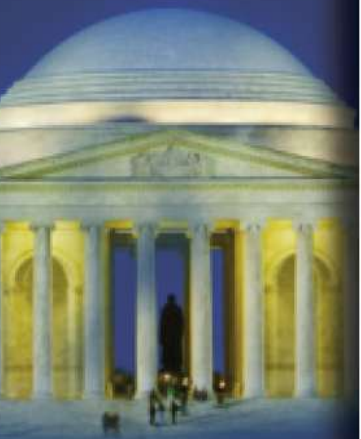
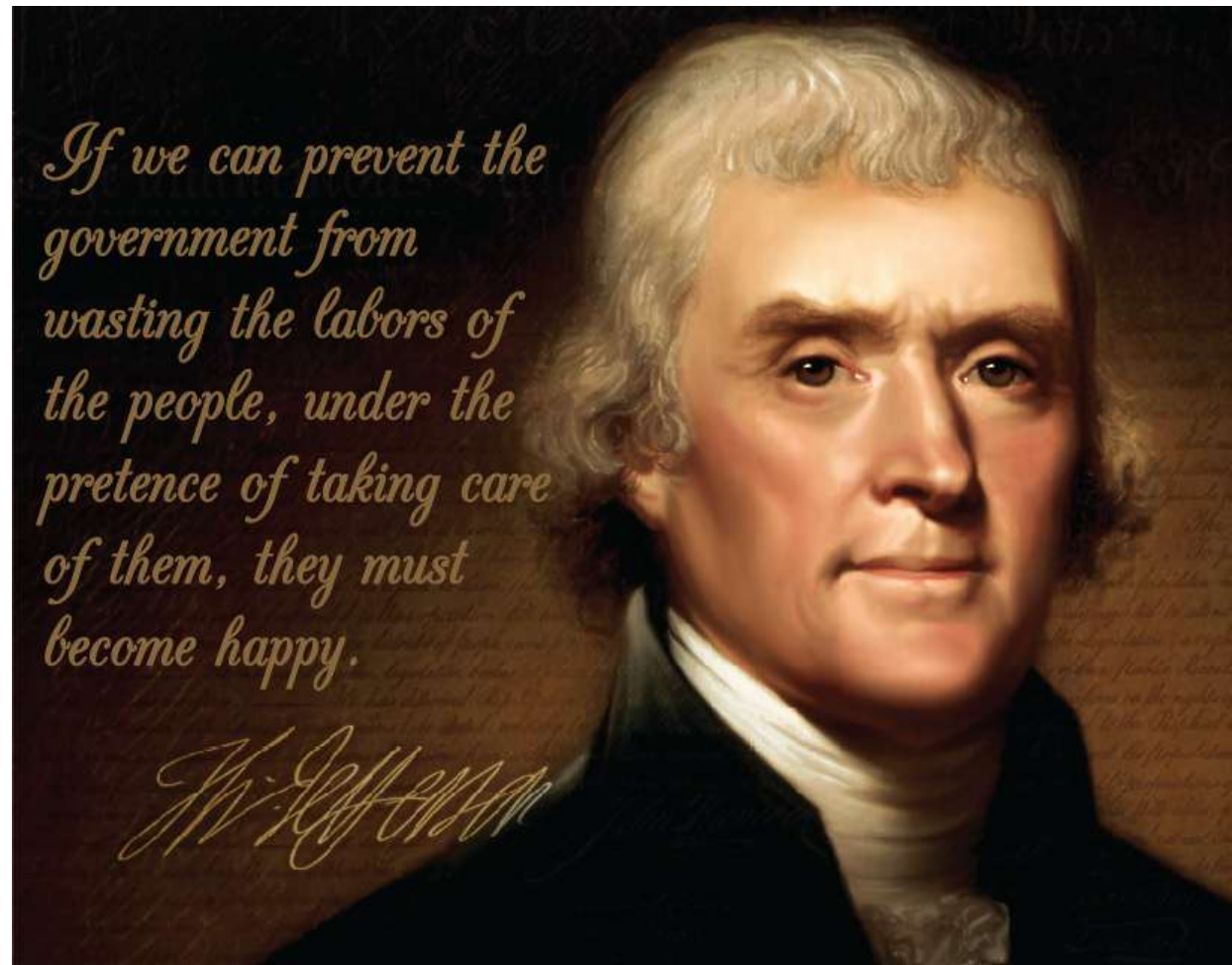


Strong Controls Culture

- Essential to:
 - Effectiveness and efficiency of operations
 - Reliability of financial reporting
 - Compliance with laws and regulations
 - Safeguard public resources
 - Obtain objectives and outcomes

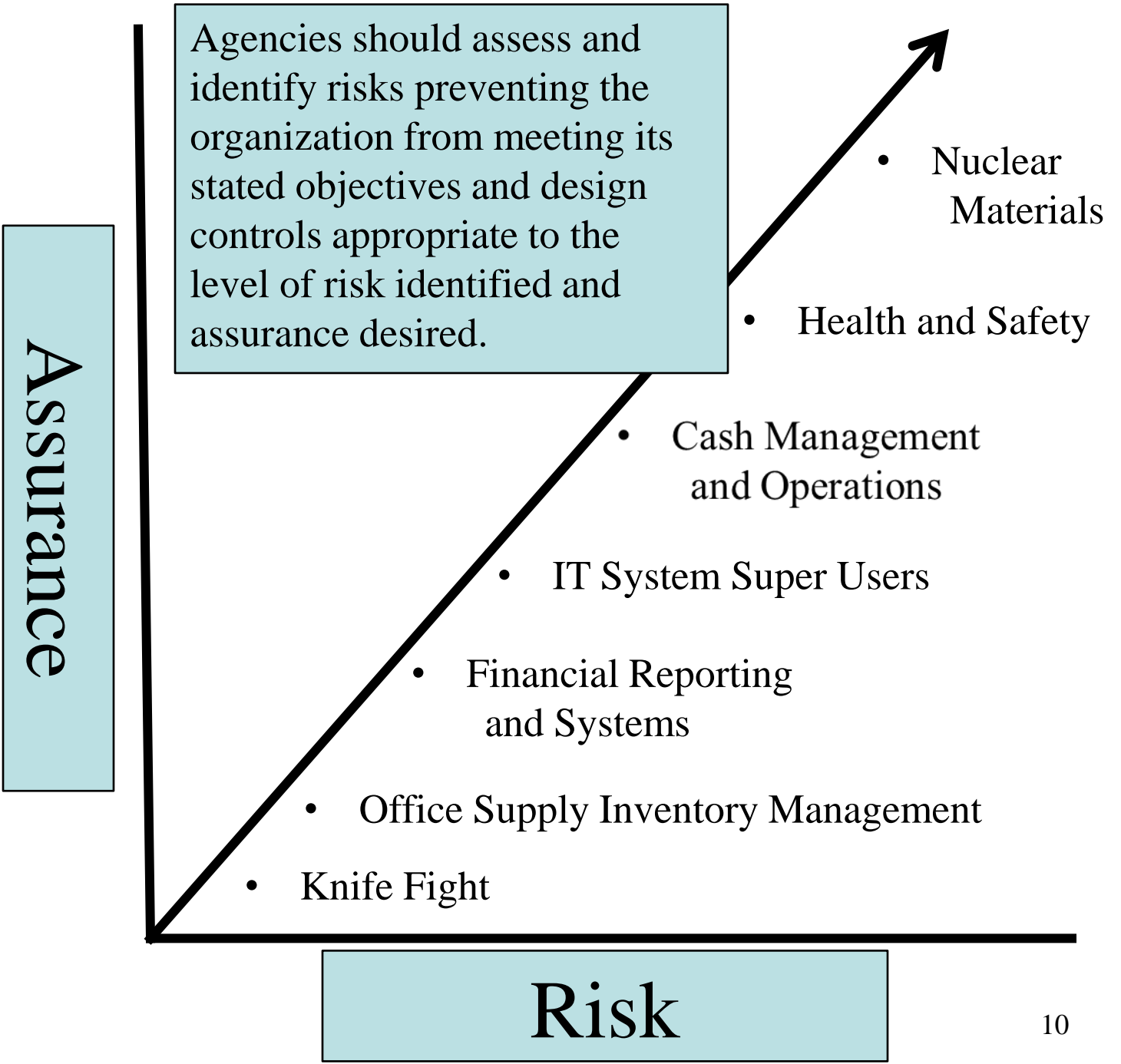
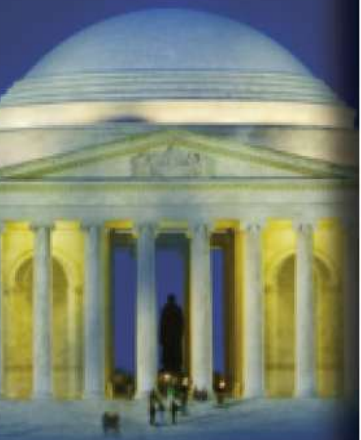


An organization's culture, structure and processes used to delegate responsibility and authority establish the overall control environment. Sound controls help detect and prevent waste, fraud and abuse and ensure objectives are met.



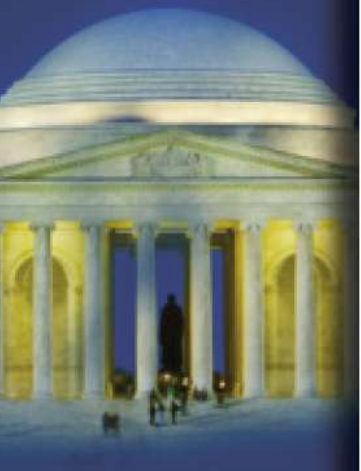
Internal Controls—Implement, Assess, Adjust

- Define the control environment
 - How the entity is organized and managed
 - Prevailing laws, policies and regulations
- Assess risk— isolate risks (internal/external) preventing the organization from achieving its objectives
- Design or enhance controls based on risk assessments
- Monitor and test control design and operational effectiveness—document results
- Assess test results and redesign or improve controls as necessary
- Disclose material weaknesses and develop corrective action plans



Management's Responsibilities

- Communicate internal control objectives and ensure organizational accountability
- Oversee processes to assess controls
- Identify and disclose material control deficiencies
- Manage resources to correct deficiencies





Correcting Control Deficiencies

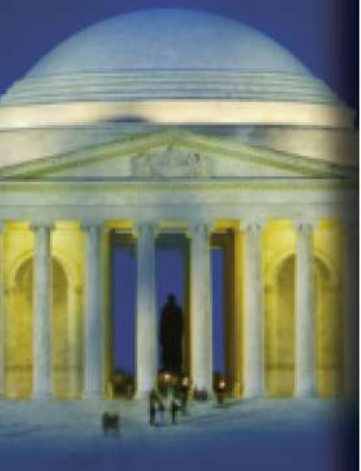
- Any deficiency that needs to be reported or disclosed *outside* the agency is a material weakness
 - (Omission or misstatement probable to change the judgment of a reasonable person)
- Corrective action plans should be developed for all reported material weaknesses—the plans should:
 - Identify senior official responsible for corrective actions
 - Document required actions in performance plans
 - Require prompt resolution
 - Maintain accurate status of corrective actions
 - Ensure compliance with laws, policies and regulations
 - Identify and apply required resources
- Management is responsible for disclosing material weaknesses and overseeing corrective actions

District of Columbia Tax Office

- Mid level tax office employee masterminded scheme to embezzle \$48 million over 20 years
- Leveraged knowledge of poor controls, inefficient business processes and IT systems plagued with significant ‘work-arounds’
- Processed bogus tax refunds sent to 10 other coconspirators
- Many had legitimate businesses used for cover
- Mid level bank employee assisted in depositing refund checks
- Independent outside report blamed a “culture of apathy and silence”
- Recent internal audits indicate poor control environment continues to persist

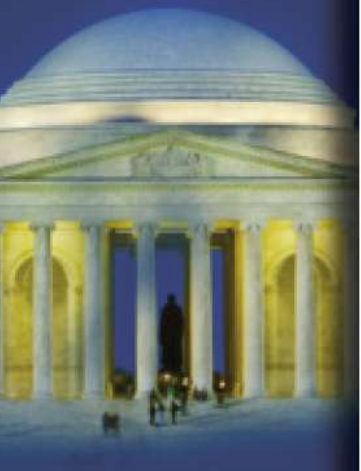
District of Columbia Tax Office

- Corrective actions should include:
 - Clearly communicated objectives and outcomes defined by top management
 - Risk assessment—segregation of duties
 - Repeated testing of control design and operation
 - Objective means to measure performance and accountability
 - Disclosure of control weaknesses and required corrective actions



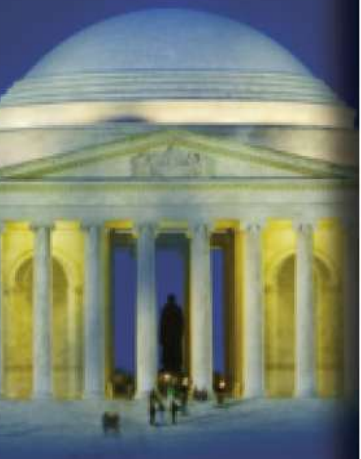
Audit Ready

- Auditors will design audit procedures based on assessment of internal controls
 - Evaluate design and operation of internal controls
 - Determine if controls as designed and implemented enable management to prevent, detect, or correct misstatements
- Assess reliability—**are financial statements fairly presented and free of material misstatements?**



Fairly Presented

- Accounting principles are appropriate
- Accounting principles are applied correctly
- Financial statements are informative
- Information is reasonably classified and summarized
- Financial statements reasonably reflect the entity's:
 - Financial transactions
 - Financial events
 - Financial position
 - Results of operations





Free of Material Misstatement

- Omission or misstatement probable to change the judgment of a reasonable person
- Management is required to assert/represent financial statements are free of material misstatement for the following:
 - Existence—Ownership interests exist and recorded transactions represent events that actually occurred
 - Completeness—Transactions required to be recognized have actually been recorded
 - Rights and obligations—Assets reflect the entity's rights and liabilities reflect the entity's obligations
 - Accuracy—Transactions are mathematically correct and reported at the appropriate amount
 - Cut off—Transactions recorded in proper period
 - Classification—Statements are understandable

Key Take-Aways

- Management must communicate clear objectives, methods to measure results, and accountability
- Internal controls provide:
 - Reasonable assurance of efficient and effective operations
 - Reliability of financial statements
 - Compliance with laws and regulations
- Controls must be tested for effective design and operation
- Risk assessments inform controls design and operation
- Financial reporting controls must:
 - Prevent, detect, correct material misstatements
 - Ensure statements are fairly presented

Sources

- Wyoming Depart of Transportation
Internal Review Services
- Understanding Internal Control and
Internal Control Services (Thomas A.
Ratcliffe, CPA, and Charles E. Landes,
CPA)
- OMB Circular A-123
- Army Regulation 11-7
- Financial Audit Manual—GAO

Wrap Up/Questions?

