To Master Study List

Strengthening Governance and Internal Controls in Utah County Governments

Executive Summary

Version 1.0

Prepared by a Volunteer Task Force consisting of members of The Institute of Internal Auditors – SLC Chapter

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+ centrally assessed property value

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Table of Contents

SUMMARY OF ISSUES 1
SUMMARY OF RECOMMENDATIONS 5
POLITICAL DISCLAIMER 7

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Summary of Issues

There are three primary areas of concern related to internal controls and internal audit in Utah counties. Below is a list of each topic and related issues. *Correcting each of these issues should be considered mandatory if lawmakers want to better protect taxpayer assets and bring county organizations into compliance with internal control and internal audit professional standards.*

County Internal Control Structure

Issue 1: §17-36-45, the internal control structure portion of the Uniform Fiscal Procedures Act, is out of date with regards to modern risk management and internal control practices. (See *Appendix A: Model Risk Management and Control Policy Statement* in the full issues paper.)

The current internal control structure does not reflect modern expectations and needs to be updated.

Governance Controls in Two Forms of County Government

Issue 2: There are definitional issues with the title "County Auditor" and there are internal control problems in §17-19a related to budgeting and accounting at the governance level (elected officials) of county governments with commissioner/council-manager forms of government.

While the title "County Auditor" is still used in many parts of the United States, it is outdated and no longer describes the actual principal duties carried out by this elected official. The title "County Controller" is one alternative to consider.

In addition, §17-19a creates some significant segregation of duties issues. While current segregation varies slightly from county to county, Tables 1 and 2 summarize the impact of 19a.

§17-19	Commission	Auditor	Treasurer
Authorize	√		
Execute		√ (urgent)	√ (routine)
Record		√	
Maintain Custody	√ (assets)		√ (cash)
Audit		√	

Table 1: Segregation of Duties Under §17-19

§17-19a	Commission	Auditor	Treasurer
Authorize	X		
Execute	X (urgent)		√ (routine)
Record	X		
Maintain Custody	X (assets)		√ (cash)
Audit		√	

Table 2: Segregation of Duties Under §17-19a

There are at least two options available to restore adequate segregation of duties at the governance level (elected officials) of county governments with commissioner/council-manager forms of government.

The Audit Function in County Governments

Issue 3: The audit scope/universe outlined in 19a does not adequately protect all taxpayer assets and is not in compliance with professional audit standards.

19a only allows internal auditors to audit "financial records" (§17-19a-204(1)(a)). See Exhibit 1. This impacts the entire organization negatively because it leaves out five of the six areas where internal audit needs to operate in order to provide county leaders with valuable information. That is *a lot* of potential loss and/or inefficiency that is not being evaluated. This puts potentially millions of dollars of taxpayer assets at risk.

Exhibit 1: Partial Audit Universe Dashboard

Utah taxpayers would considerably benefit from modifications to §17-19a. In particular, enhancing specific sections in §17-19a by clearly outlining all six areas mentioned in the above exhibit would give the chief internal auditor the authority to address any area in county operations where waste, abuse, fraud, or any other type of loss may occur. These modifications would allow internal auditors to evaluate and audit all types of risks and to better protect all taxpayer assets. See Exhibit 2 below.

Exhibit 2: Full Audit Universe Dashboard

Issue 4: The structure of the audit function in 19a does not comply with professional audit standards and 19a does not provide adequate organizational independence for internal audits.

Independence from executives and other management is crucial to the success of an internal audit function (see Standard 1110 and Appendix D of the full issues paper). The GAGAS standard related to internal auditor independence states that the head of the audit organization must be "sufficiently removed from political pressures to conduct audits and report findings, opinions, and conclusions objectively without fear of political reprisal."[1]

Governmental and business organizations generally create this independence using the following audit-standard's-based strategies:

a) Establish the position of "chief audit executive."
b) Establish shared internal audit services for smaller organizations.
c) Create "audit committees" (to achieve audit independence this is *mandatory*). These committees have responsibilities as outlined in IIA and other audit standards.
d) Put all internal audit duties under the functional authority of the audit committee (to achieve audit independence this is *mandatory*).
e) Require minimum professional qualifications, including certifications, for the chief audit executive and require these audit skills be kept up-to-date.

One option is known as the "dual-reporting relationship" and is outlined in Exhibit 3 below.

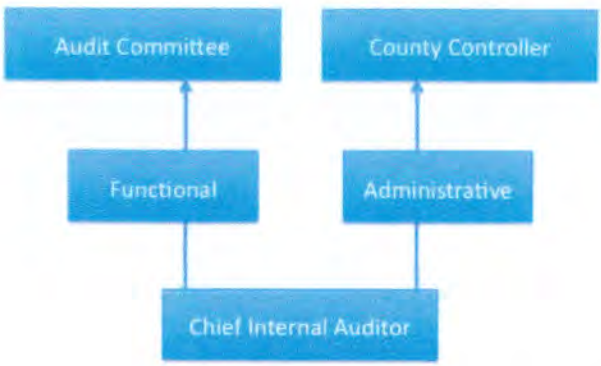

Exhibit 3: Independence via a Dual-Reporting Relationship

[1] GAO, 3.31

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Summary of Recommendations

To best protect taxpayer assets, the language added to Utah Code should adhere to the following professional requirements:

Issue 1:

- ☐ Include all the principles and concepts outlined in Appendix A, paragraphs 1 and 2 (see IIA 2110, 2120, and 2130). Appendix A also includes potential redlines to state code. (Appendix A can be found in the full issues paper.)
- ☐ Include the following elements related to "segregation of duties" (see IIA 2110):
  - the duty to authorize transactions;
  - the duty to execute transactions;
  - the duty to record transactions; and
  - the duty to maintain custody of assets; and
  - the duty to oversee/review/audit transactions.

Issue 2:

- ☐ Discontinue using the title "auditor" for the "County Auditor" elected official and replace it with a title that is more descriptive of the actual principal financial duties of this official, such as County Controller.
- ☐ *Option 1*: Modify §17-19a-203 and 205 for commissioner and council/manager forms of government to return the accounting and budgeting functions to the county controller (see IIA 2120.A1).
- ☐ *Option 2*: Rescind §17-19a-101(2)(b)(i) for counties with commission or county/manager forms of government and make modifications to 19 that bring the audit function into compliance with professional audit standards (see Issues 3 and 4 below).

Issue 3:

- ☐ Expand the definition of audit and the universe of all forms of audit currently described in Sections 102, 204, 206, and 401 and Chapter 19 (if applicable) to include:
  - (i) Code of conduct (see IIA 2110 and 2110.A1; GAGAS 6.33-6.34),
  - (ii) Assets (see IIA 2120.A1; GAGAS 4.02),
  - (iii) Financial records and processes, including the detection and prevention of fraud (see IIA 1220.A1, 2120.A1, 2120.A2; GAGAS 2.07, 2.11(b), 4.06, 6.16-6.22, 6.30-6.32),
  - (iv) Operational efficiency and effectiveness (see IIA 2120.A1; GAGAS 2.11(a)),
  - (v) Information technology (see IIA 1210.A3, 2110.A2, 2130.A1; GAGAS 3.72, 6.23-6.27), and
  - (vi) Compliance (see IIA 1220.A1 and 2120.A1; GAGAS 2.11(c), 4.06, 6.28-6.29).

As described above, the end result should be a Section 204 that focuses on the internal audit of financial records and assets and Sections 206 and 401 that focus on financial processes, codes of conduct, compliance, operations, and information technology.

Issue 4:

- ☐ Establish the position of "chief internal auditor" for counties of the first, second, and third class (see IIA 1000, 1110, 1111, 1130.A2, etc.; GAGAS 3.31).[2]
- ☐ Establish an internal audit function for counties of the fourth, fifth, and sixth class (see IIA 1000, 1110, 1110.A1, 1111, and 1120; GAGAS 3.31).
- ☐ *Mandatory*: Create an audit committee for all counties (see IIA 1110; GAGAS 3.27, 3.31, and 3.88). The characteristics of this committee should include:[3]
  - (i) The committee should be as politically balanced and/or as apolitical as possible;
  - (ii) Members should have no conflict of interest with the county;
  - (iii) Members should have no immediate family members who work for the county or are elected officials in the county;
  - (iv) Members should understand the fundamentals of financial statements, financial reporting, compliance, operational auditing processes, and internal controls; and
  - (v) At least one member should be a financial expert who understands complex and technical financial issues.
- ☐ *Mandatory*: Ensure internal audit independence by placing the internal audit function under the functional authority of the audit committee (see IIA 1100, 1110, and 1111; GAGAS 3.27, 3.31, and 3.88; GAGAS 1.04-1.07).

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[2] Another option in addressing issues 3 and 4 is to place counties and other government organizations in the state under the jurisdiction of the Utah Internal Audit Act.

[3] Bailey, James A., p. 29

Political Disclaimer

It is important that the authors openly recognize one critical issue. If all of the recommendations in the full issues paper are implemented—something that is ideal for taxpayers—the result in executive/council forms of county government would be a 19a that would create the required independence for the internal auditor by removing this function from the county controller and moving it functionally to the audit committee. Combined with the powers given to the county executive and county council in 19a sections 203 and 205 this allows the executive/council to significantly diminish the responsibilities of the county controller's office. From an internal controls perspective this is irrelevant—there are adequate internal controls elsewhere. However, the authors recognize the political implications, but must concede that addressing these implications is beyond the scope of the paper.

The purpose of these recommendations, as a whole, is to help lawmakers design an internal control system that increases the protections over taxpayer assets. Therefore, the authors request lawmakers implement all the recommendations contained herein in a manner that respects the legislated balance of responsibilities in executive/council forms of government between the office of the county controller, county executive, and county council.