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As ordered by the Texas Association of County Auditors Board of Directors, 10/11/2005.

AUDIT GUIDE

For Texas Counties

Texas Association of County Auditors

Compiled By
The Education Committee of The
TEXAS ASSOCIATION OF COUNTY AUDITORS

AUDIT GUIDE

FOR TEXAS COUNTY AUDTORS

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TEXAS ASSOCIATION OF COUNTY AUDITORS

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
MISSION STATEMENT

The Texas Association of County Auditors' Mission Statement will be added to this Guide after its adoption by the TACA membership in the October 1996 Annual Conference

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
CODE OF ETHICS

The Texas Association of County Auditors' Code of Ethics will be added to this Guide after its adoption by the TACA membership in the October 1996 Annual Conference

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TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
INTRODUCTION TO THIS GUIDE

County Government is, for many people, the primary, most accessible level of government. In true democratic fashion, officials are elected from among the populace to represent citizens, provide a variety of services, and act as a bridge to span the gap between local citizens and State Government. In the midst of these elected positions is one, apolitical, appointed official - the County Auditor. The County Auditor has a broad scope of duties and responsibilities. Among other jobs, the County Auditor is to serve as a "check" on the financial operations of other county offices, as well as fulfill financial accounting and budget responsibilities.

The general duties and responsibilities of the County Auditor are spread throughout the Local Government Code, Government Code, Code of Criminal Procedures and other statutes. There are over 250 references throughout the statutes concerning the County Auditor. There is no indication that any one function has a higher priority than any other required function of the office. It is the responsibility of each County Auditor to use his/her own professional judgement in deciding to what degree, and in what order, he/she fulfills those prescribed duties.

County Auditors from across the State of Texas have expressed a need for some guidance and direction in performing one of their required duties - auditing. The Education Committee of the Texas Association of County Auditors (TACA) has developed this Audit Guide in an effort to help satisfy that need. The Education Committee has gone to several reliable sources for guidance in the preparation of this Guide. Among them are the Texas State Comptroller's Office, CPA firms that have heavy county government practices, and various experienced County Auditors. Many hours have gone into the preparation of the Guide, but it is not meant to stay in its present form forever - it is meant to be a living document. The Education Committee (or the proposed Audit Guide Committee, if it is approved by the members of TACA in October 1996) will continue to work closely with the Law Study Committee and all the members of TACA to update it and expand it, continuously. The Guide is presented in a codified format rather than with numbered pages to facilitate such updates - sections can and will be added, edited or deleted without affecting the page numbering in subsequent sections.

All readers should understand that this Guide is in no way meant to prescribe any one particular auditing technique. Nor does it imply that the audit function of the County Auditor carries any greater weighted importance than any other prescribed duty. It is simply intended to serve as a tool to help County Auditors in carrying out their auditing function. It also provides an overview of some of the other duties of County Auditors, starting with the definition and specific duties of the office, and progressing to specific methodologies of auditing and fraud detection in Texas county government.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
THE COUNTY AUDITOR'S OVERALL STATUTORY RESPONSIBILITIES

INTRODUCTION

The authority of the county auditor is probably best summarized in a statement made by W. C. Murphy in his article, County Government and Administration in Texas (University of Texas Bulletin, 1933): "Since the auditor has the authority to impose a budget on the county, because of his power to stop payment on all warrants not drawn strictly according to the law, he has been in a position to dominate county finances." Since the creation of the position of county auditor in 1905, the county auditor has been referred to as the "connector" and the "lynch-pin" of county government, due to the fact that the position is not elected. The county auditor is appointed by the district judge(s) having jurisdiction over the county, and as such the county auditor is not controlled by the commissioners' court. The real significance of the county auditor's authority stems from the oath of office (**Texas Constitution Art. XVI, §1**, with the added wording **"will not become personally interested in a contract with the county"**) and the obligation to ensure strict enforcement of state laws and the duty to disallow any expenditure of county funds he believes to be unlawful.

The county auditor is called on in many instances to reach a legal decision (and most often the auditor is not an attorney) based upon the examination of underlying documents and an interpretation of state laws. The chief role of the position is the role of financial officer of the county. As such the county auditor has full comprehensive authority to direct accounting procedures, stop illegal payments, and to establish internal control procedures for the custodial maintenance of county assets.

Today it is required that all counties with a population in excess of 10,000 will have a county auditor appointed (**LGC §84.002**). The county auditor has the responsibility and the authority to audit all areas that have custody of money or property that belongs to the county, that is intended for county use, or is held in some official capacity by a county official. This responsibility is an "audit" function, and has the general objective to ensure that the financial integrity of the county's financial operations is maintained.

The county auditor should never equate the authority and responsibility of the office to "power". The duties of the county auditor are prescribed by state law, prescribed by the standards and ethics of the profession, inherited, and some duties are assigned because no one else wants to do them.

Once appointed the county auditor must be qualified to be an accountant, an auditor, an attorney, an economist, a public relations manager, a financial forecaster, a budget expert, a personnel director, a purchasing agent, a politician, and possibly a resident expert on cleaning compounds and toilet tissue.

APPOINTMENT

The county auditor is an appointed position (**LGC §84.002**) and reports directly to the district judge(s) that appointed the position. The procedure for appointment (**LGC §84.003, §84.005**) and the term (**LGC §84.005**), two years, are consistent for all counties, except those greater than 2,000,000 in population. The qualifications for the county auditor are established by **LGC §84.006**, and the bond and oath are set out in **LGC §84.007**. When the population of the county is less than 25,000 **LGC §84.008** establishes guidelines for joint employment. **LGC §84.009** sets out the criteria for the removal of the county auditor.

Once the county auditor has been appointed by the district judge(s), it is then the county auditors responsibility to work within the available budget to hire and appoint assistants (**LGC §84.021**). Anyone who works for the county auditor is an assistant county auditor. The county auditor must receive 40 hours each term of continuing education in courses relating to the duties of the county auditor and certify the same to the district judge(s) (**LGC §84.0085**). The county auditor has the ability to buy materials and supplies to run the office and this is established by **LGC §84.901 (Commissioners' Court of Harris County v. Fullerton, county auditor, 1980, Tex. Civ. App. 596 S. W. 2d 572)**. The county auditor's operating budget is established by the county auditor and the commissioners' court annually during budget hearings. The district judge(s) may set the county auditor's salary at a level which is determined to be adequate, but can not increase the county auditor's budget

from one fiscal year to the next for expenses and assistant auditor's salary by more than 5% without the approval of commissioners' court (**LGC §111.013, 111.044, 111.074**).

The county auditor's salary and the salary of the assistant county auditor's are set annually by order of the district judge(s) to the commissioners' court (**LGC §152.031 - §152.034**). The county auditor's salary and the salary of assistants are exempt from the compensation statutes as set out in **Local Government Code §152.001-016 (LGC §152.017)**. The county auditor is permitted to be reimbursed for the use of a personal automobile in performance of the duties of the office (**LGC §152.035**).

The district judge(s) will hold a public hearing annually to set the salaries of the county auditor and assistant county auditors (**LGC §152.905**).

COUNTY AUDITOR AUTHORITY

It is often difficult to determine where "authority" stops and "responsibility" starts. Statutory authority establishes the legal rights that enhance the county auditor's ability and make it possible to fulfill statutory responsibility. There are four types of statutory authority conferred upon county auditors, all of which overlap with each other throughout the statutes:

- Oversight Authority
- Access Authority
- Prescriptive Authority
- Verification Authority

OVERSIGHT

Local Government Code §112.006

(a) The county auditor has general oversight of the books and records of a county, district, or state officer authorized or required by law to receive or collect money or other property that is intended for the use of the county or that belongs to the county.

(b) The county auditor shall see to the strict enforcement of the law governing county finances.

Local Government Code §320.043
Local Government Code §320.047

Concerning the oversight responsibility when a Park Commission exists.

Local Government Code §324.097

Concerning the oversight responsibility when a Recreation District exists.

Oversight generally means watchful and responsible care for. Watchful and responsible care for implies not only access to the books and records, but also the authority to help ensure that those books and records are properly maintained. In Smith v. McCoy (Civ. App. 1976) 533 S. W. 2d 457, it was determined that the county auditor has responsibility, before approving a claim against the county, to determine whether the claim strictly complies with the law(s) governing county finances.

NOTE: When the county auditor is required to deal with statutes that have population brackets, it should be remembered that the population that is being referred to is based on the last Federal census.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
THE COUNTY AUDITOR'S OVERALL STATUTORY RESPONSIBILITIES

ACCESS

Local Government Code §115.001

The county auditor shall have continual access to and shall examine and investigate the correctness of:

- The books, accounts, reports, vouchers, and other records of any office;
- The orders of the commissioners' court relating to county finances.

In many instances the authority established by the statutes are very broad - but they are specific. The above statue would include all reports made by all offices to the commissioners' court and would include all evidentiary matter; i.e. books of original entry, accounts maintained, reports other than those made to the court, vouchers, and any other records deemed necessary. Financial records and documents would not be limited to fiscal evidence, but would also include internal policies and internal controls. Reports dealing with collection of money, bank reconciliations, deposits, disbursements, court records, and safe guarding of assets would be essential.

Local Government Code § 140.003

(g) The county auditor, if any, of the county that manages a specialized local entity's funds has the same authority to audit the funds of the entity that the auditor has with regard to county funds.

Note: a "specialized local entity is a district, a criminal district attorney, a juvenile board, a juvenile probation office, an adult probation office or a judicial district.

Code of Criminal Procedure §103.11

The county auditor has the authority to examine the receipt books of officials collecting fines and fees in criminal cases for the county to determine whether the money collected has been properly disposed of.

Access generally means the liberty to enter, look at or review. This would include all specialized local entities (ref. Att. Gen. Op. JM-1275, 1990). Generally speaking the county auditor may look at anything that pertains to county finances (ref. Att. Gen. Op. M-756, 1970; H-1185, 1978, H-1212, 1978).

PRESCRIPTIVE

Local Government Code §112.001

In a county with population of less than 190,000, the county auditor may adopt and enforce regulations, not inconsistent with law or with a rule adopted under **LGC §112.003**, that the auditor considers necessary for the speedy and proper collecting, checking and accounting of the revenues and other funds and fees that belong to the county.

Local Government Code §112.002

(a) In a county with a population of 190,000 or more, the county auditor shall prescribe the system of accounting for the county.

Additional references:
Att. Gen. Op. JM- 1275, 1990
Att. Gen Ltr. Op. 92-50, 1992

Local Government Code §114.002

The county auditor shall determine:

(1) The time and the manner for making reports to the auditor, and

(2) The manner for making an annual report of:
(A) office fees collected and disbursed, and
(B) the amount of office fees refunded to the county in excess of those that the officer is permitted by law to keep.

Local Government Code §130.902

Any county official that collects public funds may request that the county make a change fund available, and the commissioners' court may set aside funds from the general fund for such a purpose, once the county auditor has approved the amount and the purpose.

Local Government Code §130.905

In counties with a population of 800,000 or more the county may establish a welfare fund to provide support for paupers. The fund is established under a system provided and installed by the county auditor.

Prescribe generally means to require or dictate, and this type of authority allows, and in some cases requires, county auditors to prescribe accounting and/or bookkeeping systems, and to prescribe frequency, format and content of reports. Attorney General opinions have extended this authority to the County Attorney's "hot check fund" and to the Sheriff's "commissary fund".

Local Government Code §154.044

All district, county and precinct officers are required to file by the 5th day of the month a report (as specified by the county auditor) with the county auditor which details the fees and commissions collected for the previous month and an itemized sworn statement as to the expense claims paid during the period.

VERIFICATION

Local Government Code §113.064

(a) In a county that has the office of county auditor, each claim, bill, and account against the county must be filed in sufficient time for the auditor to examine and approve it before the meeting of the commissioners' court. A claim, bill or account may not be allowed or paid until it has been examined and approved by the auditor.

(b) The auditor shall stamp each approved claim, bill or account. If the auditor considers it necessary, the auditor may require that a claim, bill, or account be verified by an affidavit indicating its correctness.

(c) The auditor may administer oaths for the purposes of this section.

Additional References:
Att. Gen. Op. M-955, 1971
Att. Gen. Op. O-6784, 1945
Att. Gen. Op. JM-192, 1984

This type of authority relates to the claims approval process and allows auditors to obtain sworn statements or testimony relating to the validity of claims, bills or accounts.

Local Government Code §154.043

(b) A payment may not be made from the salary fund to an employee for a service performed before the person has taken the constitutional oath of office, if applicable, and the authorized appointment and oath, if any, have been filed with the county clerk and the county auditor.

Property Tax Code §26.044

The county auditor is required to certify the number of "paper ready" inmates and the number of inmate days that were spent in the county jail facility by "paper ready" inmates awaiting transfer to a division of the Texas Department of Correction. The county auditor is to verify the amount that the county spent in a twelve month period for the maintenance and upkeep of these prisoners that are awaiting transfer. The verification is based on a review of the records maintained by the county sheriff.

COUNTY AUDITOR - AUDIT RESPONSIBILITIES

There are three offices in county government which have the statutory responsibility to audit: commissioners' court, county treasurer and the county auditor. All have the responsibility to ensure that:

- All funds due to the county are being collected within some reasonable assurance;
- All funds being held by the county are being adequately safeguarded;
- All funds being collected are being disposed of properly;
- All county property is being used and managed properly;
- All county assets are accounted for; and
- There are responsible parties held accountable for county property.

All are required to support the efforts of the other offices in strengthening the financial management and responsibility of the county. The responsibilities of the county auditor are much broader than those given to either the commissioners' court or the county treasurer. Often the position of the county auditor is viewed as a bookkeeping function, rather than one of accounting and auditing.

The statutes contain three separate audit responsibilities for all county auditors:

Local Government Code §115.002

(a) The county auditor shall carefully examine and report on all reports about the collection of money for the county and that are required to be made to the commissioners' court.

(b) At least once each quarter the county auditor shall check the books and shall examine the reports of the county tax assessor, county treasurer, and all other officers. The auditor shall verify the footings and the correctness of those books and reports. The auditor shall either stamp the books and reports approved or shall note any differences, errors or discrepancies.

(c). The auditor shall carefully examine the report made under **§114.026** by the county treasurer together with the cancelled warrants (checks) that have been paid. The auditor shall verify those warrants with the register of warrants issued as shown on the auditor's books.

In addition:

Local Government Code §115.003

The county auditor is required to verify that the funds maintained by the county treasurer are intact and correctly reported.

Local Government Code §115.0035

At least once each county fiscal year the county auditor is to fully examine the accounts of all precinct, county and district officials. This statement seems to be repeated at:

Local Government Code §114.041

(a) In a county with a population of 190,000 or less, a district, county or precinct officer shall keep, as part of a record provided for the purpose, a statement of fees earned by the officer and of the money received by the officer as deposits for costs, trust fund deposits in the registry of a court, fees of office and commissions. The officer must make an entry in the record when the fees or commissions are earned or the deposits are made and when the money is received. The county auditor shall annually examine the records and accounts of each officer and report the findings of the examination to the next grand jury or district court.

Local Government Code §115.004

Special requirements for county auditors in counties with a population of more than 190,000.

Local Government Code §115.901

The county auditor shall examine the accounts, dockets and records of each clerk, justice of the peace, and constable and of the sheriff and county tax assessor-collector to determine if any money belonging to the county and in the possession of the officer has not been accounted for and paid over according to law.

The word "accounts" is often used throughout the statutes and should be understood to mean all public funds subject to the control of any precinct, county or district official, including money seized by law enforcement agencies and the attorney for the state; but it does not include funds received by the attorney for the state from the Comptroller under the General Appropriations Act, or federal or state grant-in-aids funds received by an official (**LGC §115.0035**).

Money may be paid out of a registry fund maintained by a court, but these disbursements must be submitted to the county auditor for review, verification and countersignature (**LGC §117.121**). These funds held in a registry fund are to be audited annually, and a written report delivered to the county judge, each commissioner, and the clerk of court 90 days after the last day of the fiscal year. The audit is a public document and should be held available for public inspection (**LGC §117.123**).

Local Government Code §351.0415

(d) At least once each county fiscal year, or more often if the commissioners court desires, the auditor shall, without advance notice, fully examine the jail commissary accounts. The auditor shall verify the correctness of the accounts and report the findings of the examination to the commissioners court of the county at its next term beginning after the date the audit is completed,

Human Resources §152

Each county auditor should consult this chapter to understand how the juvenile board and it's related activities are to be treated. Not all are the same. This chapter deals with the creation and authority of the juvenile boards and deals with the collection and distribution of support service fees.

AUDITING OTHER COUNTY OFFICES

The extent of audits performed on other county offices depends on many factors. One of the most critical is personnel. The county auditor in a small county with a staff of one has the same responsibility (established by the statutes) and authority as does the county auditor that has a staff of 15. The office is often called upon to perform many financial functions relating to personnel, payroll, purchasing, grants, insurance, etc. These functions are for the most part above and beyond the statutory responsibilities of the office; i.e. to produce financial reports, audit account payable records, audit payroll records, and ensure that there is strict enforcement of the laws governing county finances. Chances are if the county auditor is performing all the mandated responsibilities in a county with a small staff, then audits of other offices are very possibly neglected.

The authority and responsibility that is vested in the county auditor is derived from the Vernon's Texas Codes Annotated, which is a codification of the statutes and laws passed by the Texas legislature. From these statutes the county auditor has four derived audit objectives:

- To ensure that an official has collected all the funds or other property that he/she is entitled to; the money/property is actually checked within the officials's possession, making sure that the proper amounts have actually been received. This procedure should include the evaluation of supporting documentation for the amounts received. Review internal controls to evaluate if a diligent effort is being made to collect past due amounts.

- To ensure that the funds collected by a county official is remitted to the appropriate party; to include the county treasurer, the state, refund claimants, and others. An effort should be made to insure that remittances are made in a timely manner in conformity with the Statutes, Contract, or the Rapid Deposit Law. All refunds and dismissal should be handled in a timely manner.

- All funds and property that is the responsibility of the county is properly managed and safeguarded (insured, bonded, safe deposit, internal controls). It should be documented that all investments and deposits are in compliance with the state and local depository and investment policies. All equipment and machinery owned by the county is being used solely for county purposes. And the county auditor is to ensure that all grant administrators are in compliance with grant provision.

- All funds and other property is properly expended, accounted for and reported. Ensure that all disbursements are made from the proper fund, in compliance with statutes, contracts and the budget. Ensure that all amounts disbursed are to the correct party, are legally owed and are in compliance with the Prompt Payment Act. The accounting system is established in accordance with statute and reflects what has actually occurred within the county. The

bookkeeping systems employed throughout the county are to reflect the actual occurrences. Ensure that all reports are accurate and timely.

PURCHASING AND THE APPROVAL OF CLAIMS

The county auditor has the authority to disapprove claims against the county, but even so this authority is not absolute. The statutes have established a basic criteria for all claims against the county:

Local Government Code §113.901

(a) Except as provided by subsection (c), a county auditor may not audit or approve an account for the purchase of supplies or materials for the use of the county or of a county officer unless a requisition, signed by the officer ordering the supplies or materials and approved by the county judge, is attached to the account. The requisition requirement is in addition to any other requirements of law.

Note: This aspect of the county auditor's office is probably the most litigated, due to the authority of the county auditor to disapprove of a claim.

Note: The requisition (purchase order) is to be in triplicate and the original is required to have been delivered to the person from whom the purchase is to be made.

The auditor shares the responsibility for approving claims against the county with the commissioners' court. The county auditor may be required by the commissioners' court to act as the purchasing agent (**LGC §262.012 (a)**) for the county. That responsibility normally falls to the county judge in counties where there has not been a purchasing agent designated by the district judge(s) or the commissioners' court (**LGC §262.011**). It is the responsibility of the commissioners' court to "audit and settle all accounts against the county" and to authorize their payment (**LGC §115.021**). In counties with a population of greater than 100,000 the commissioners' court may employ a person to act as the county purchasing agent (**LGC §262.0115**). When this option takes place then the person so appointed shall carry out the functions prescribed by law for the county auditor with regards to county purchases and contracts, and shall administer the procedures prescribed by law for notice and public bidding.

Each claim, bill and account against the county must be filed with the county auditor and approved by him before the commissioners' court is allowed to authorize payment (**LGC 113.064**). The prerequisites for approval of these claims are established by **LGC §113.065** and **§113.901**. Any claim must have been "incurred as provided by law", and the purchase of all materials and supplies must have a pre-approved purchase order by the county judge (or purchasing agent). The issuance of any county warrant (check) must be co-signed by the county auditor, except for those issued in payment of jury service (**LGC §113.043**). The county auditor is required to keep a register of these warrants (checks) issued by the county judge and by the district and county clerks (**LGC 113.046**).

When the law requires the county to follow competitive bidding procedures in making a purchase in excess of $15,000, and there is only one supplier from whom an item can be bought, the county auditor or other county officer or employee may not refuse payment for the purchase, because competitive bidding procedures were not followed (**LGC §262.003**).

The commissioners' court is permitted to exempt various purchases from the competitive bidding requirement (**LGC §262.024**). In the event that an exemption is granted a copy of the authorization is to remain in the purchasing office for at least one year, or until the county auditor has had an opportunity to review the transaction.

There is no procedure outlined or stated in the statutes that gives the county auditor a guide for disapproving a claim. His failure to approve a claim in a reasonable time has been determined to be the criteria to allow a vendor (claimant) to sue the county for recovery (***McLennan County v. Miller*, 257 S. W. 680, Waco 1923; Att. Gen. Op. O-6663, 1945).** The county auditor is not authorized to require, as a prerequisite to his approval of a claim for items of expense, that a requisition be signed and approved by him at the time the purchase is made or the expense is incurred. (Attorney General Opinion CM-95 dated 9/71). In the competitive bid process the auditor is required to ensure that all bids are properly advertised as required by the County Purchasing Act (**LGC §262**). The statutes provide for the establishment of exemptions, emergencies and exceptions to the standard procedure (**LGC §262.024**), and Texas Att. Gen. Op. No. O-2315, 1940 established that the county auditor did not have the authority to question the commissioners' court decision that an emergency existed.

Local Government Code §351.902

The sheriff may purchase equipment and supplies for a "bureau of criminal identification", but only in the manner prescribed by the county auditor.

ACCOUNTING RESPONSIBILITIES

The county auditor has the responsibility to be progressive and should continually strive to improve the financial recordkeeping and the financial reporting for the county. Many may not appreciate it, but the county auditor has the responsibility to help provide honest, effective and efficient government for the commercial and residential taxpayers in the county. Good county government will always be the result of a cooperative effort on the part of all county officials and county employees working towards common goals.

Local Government Code §112.001

In a county with population of less than 190,000, the county auditor may adopt and enforce regulations, not inconsistent with law or with a rule adopted under §112.003, that the auditor considers necessary for the speedy and proper collecting, checking and accounting of the revenues and other funds and fees that belong to the county.

Local government Code §112.002

(a) In a county with a population of 190,000 or more, the county auditor shall prescribe the system of accounting for the county.

Local Government Code §112.005

(a) The county auditor shall maintain an account for each county, district, or state officer authorized or required by law to receive or collect money or other property that is intended for the use of the county or that belongs to the county.

(b) In the account the auditor shall detail the items of indebtedness charged against that officer and the manner of discharging the indebtedness.

(c) The auditor shall require each person who receives money that belongs to the county or who has responsibility for the disposition or management of any property of the county to render statements to the auditor.

Local Government Code §112.006

(a) The county auditor has general oversight of the books and records of a county, district, or state officer authorized or required by law to receive or collect money or other property that is intended for the use of the county or that belongs to the county.

(b) The county auditor shall see to the strict enforcement of the law governing county finances.

Local Government code § 112.007

The county auditor shall keep a general set of records to show all the transactions of the county relating to accounts, contracts, indebtedness of the county, and county receipts and disbursements.

Local Government Code §113.023(b)

The county treasurer is to ensure that a duplicate copy of all receipts issued, shall be signed and rendered to the county auditor, who is responsible for seeing that the receipt is properly recorded in the general ledger and journals of original entry.

Local Government Code §113.903

With the consent of commissioners' court the official to whom funds are owed, a district, county or precinct officer authorized by law may receive funds or collects amount due to another county, district or precinct office. The county auditor is responsible for setting up the accounting procedures to ensure that the funds are properly handled and accounted for.

REPORTING RESPONSIBILITIES

Local Government Code §114.002

The county auditor shall determine:

- The time and manner for making reports to the auditor, and
- The manner for making an annual report of:
  - Office fees collected and disbursed, and
  - The amount of office fees refunded to the county in excess of those the officer is permitted by law to keep.

Local Government Code §114.003

(a) A county official or other person who is required under this subtitle to provide a report, statement, or other information to the county auditor and who intentionally refuses to comply with a reasonable request of the county auditor relating to the report, statement, or information, commits an offense.

(b) An offense under this section is a misdemeanor punishable by:

(1) A fine of not less than $25 or more than $200;

(2) Removal from office; or

(3) Both a fine and removal from office.

In counties with a population of more than 225,000 there is a monthly reporting requirement (**LGC 114.023**), which includes a publication requirement. However, all county auditor's are required to present to commissioners' court at its regular monthly meeting a tabulation of the county's receipts and disbursements by fund for the month, and a tabulation of accounts (**LGC §114.024**).

The county auditor is required to make monthly and annual reports to the commissioners' court and to the district judge(s) of the county. These reports are to show the aggregate amounts received and disbursed from each county fund; the condition of each account on the books; the amount of county funds on deposit in the county depository; the amount of county bonded indebtedness and any other county indebtedness; and, any other point of interest that the county auditor feels is proper and informative, or that the commissioners' court or the district judge(s) may require (**LGC §114.025(a)**). The annual report that the county auditor shall prepare must include a record of all transactions made during the fiscal year. The county auditor shall file the annual report at the regular monthly meeting on the commissioners' court in April of the year following the end of the year. The county auditor shall file the same report with the district judges. At the time the report is rendered to commissioners' court and to the district judges, the county auditor shall send to the bonding company of each district, county and precinct officer a report indicating the condition of that person's office. (**LGC §114.025 (b, c)**).

In addition to the reporting requirements placed on the county auditor, the county auditor has the authority to require reports to be made by a district officer, county officer, or precinct officer. The county auditor may require these officers to provide monthly and annual reports regarding any money collected for taxes, fines, or fees, as well as money disbursed and remaining cash on hand. The county auditor may at any time count the cash in the custody of these officer and verify the amount of funds on deposit at the bank and in the custody of the officer (**LGC §114.043**).

Any county officer that receives compensation based on fees collected must file a annual report by the first day of the second month following the end of the fiscal year setting out the fees collected and the compensation paid. The report is to be filed with the county clerk, who must file a copy of the report with the county auditor within 30 days of the date that the report is filed in the county clerk's office (**LGC §114.046**).

The county auditor is required to annually (for the year ending December 31st) file the *Texas County Road and Expenditures Yearly Report* with the Comptroller of Public Accounts for the State (**Road and Bridge Act, §4.204)**

In counties of more than 190,000 county officers who hold funds in trust shall be required to make a report as prescribed by the county auditor, which details the money received and disbursed for the period under report. All disbursements from these trust funds must be issued under order of the court and properly countersigned by the county auditor (**LGC §117.058**).

EXTERNAL AUDITS AND REPORTS

In addition, there are audit and reporting responsibilities that lie with the commissioners' court. Should the commissioners' feel it is justified, they can employ a disinterested, competent public accountant to audit all the books of the county, including those maintained by the county auditor (**LGC §115.031**). If the county does not have a county auditor, then the commissioners' court is required to have an independent audit conducted of the county's records and books at least once every two years (**LGC §115.041**). In counties with less than 25,000 one or more counties may jointly employ competent personnel to perform an audit in whole or in part (**LGC §115.042**). In counties of 191,500 to 200,000 the commissioners' court shall have a biennial (in each even numbered year) independent audit performed of all county records, books and finances (**LGC §115.044**).

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THE COUNTY AUDITOR'S OVERALL STATUTORY RESPONSIBILITIES

In counties with a population of 350,000 or more an annual independent audit is required (**LGC §115.045**). These audits as described are to be done in addition to those required by the county auditor.

In counties with a population of 40,000 to 100,000 the district judges(s) on the request of a grand jury may appoint an auditor to examine the condition of records and county finances in a broad or a specific character (**LGC §115.043**).

BUDGET RESPONSIBILITIES

Among the county auditors more significant duties and responsibilities is preparation of the county's budget. In a county of population of 225,000 or less the county budget officer is the county judge, who serves for the commissioners' court (**LGC 111.001, 111.002**). The county auditor assists the budget officer. The two working together prepare a budget to cover all proposed expenditures of the county government for the succeeding fiscal year (**LGC §111.003**). In counties that have a population of more than 225,000 the county auditor serves as budget officer for the commissioners' court of the county (**LGC §111.032**). Commissioners' Court has the ability to appoint a budget officer. Once appointed, if the office is ever abolished, the county auditor shall immediately assume the duties of the budget officer (**LGC §111.062**).

Local Government Code §111.034

(a) The county auditor shall itemize the budget to allow as clear a comparison as practical between expenditures included in the proposed budget and actual expenditures for the same or similar purposes that were made for the preceding fiscal year. The budget must show with reasonable accuracy each project for which an appropriation is established in the budget and the estimated amount of money carried in the budget for each project.

(b) The budget must contain a complete financial statement of the county that shows:
- (1) The outstanding obligations of the county;
- (2) The cash on hand to the credit of each fund of the county government;
- (3) The funds received from all sources during the preceding fiscal year;
- (4) The funds and revenue estimated by the auditor to be received from all sources during the preceding fiscal year;
- (5) The funds and revenue estimated by the auditor to be received from all sources during the ensuing fiscal year; and
- (6) A statement of all accounts and contracts on which sums are due to or owed by the county as of the last day of the preceding fiscal year, except for taxes and court costs.

In the budget preparation process the county auditor an/or the budget officer may require any district, county or precinct officer of the county to provide information necessary for the auditor to properly prepare the budget (**LGC §111.036, 111.065**). Once the proposed budget is prepared the county auditor will file a copy with the county clerk and available for public inspection (**LGC §111.037**). The budgeted expenditures that is approved by the commissioners' court may not exceed the funds available at the beginning of the fiscal year and the estimated revenues for the fiscal year as provided by the auditor (**LGC §111.039**). Therefore it is very important that the county auditor have a good understanding of unencumbered fund balances for all funds. Once the budget is approved the commissioners' court is required to file a copy of the approved document with the county auditor and the county clerk.(**LGC §111.040, 111.066, 111.069**).

The county auditor shall certify to the commissioners' court the receipt of all public or private grant or aid money that is available for disbursement in a fiscal year, but not included in the budget for that fiscal year. On certification, the court shall adopt a special budget for the limited purpose of spending the grant or aid money for its intended purpose (**LGC §111.043**). Duties which have not been expressly conferred to the budget officer by the statutes remain with the county auditor (**LGC §111.072**).

On the final adoption and certification of a general or special county budget, the county auditor shall open an appropriation account for each main budgeted or special item in the budget. The county auditor shall enter to an appropriation account each warrant (check) drawn against that appropriation. The county auditor shall periodically inform the commissioners' court of the status of the appropriation accounts (**LGC §111.091**). The county auditor is to oversee the warrant process to ensure that expenses of any department do not exceed the budget appropriations for that department (**LGC §111.092**).

In counties with a population of more than 225,000, the county auditor shall charge all purchase orders, requisitions, contracts, and salary and labor allowances to the appropriate accounts. Such a requisition, contract or purchase order is not binding on the county until the county auditor certifies that the budget contains ample provision for the obligation and that funds are or will be on hand to pay the obligation. The amount allocated in the budget for a requisition, contract or purchase order or labor account may not be allocated for any other purpose unless an unexpended balance remains in the account after full discharge of the obligations or unless the original charge is cancelled in writing by the order of the commissioners' court for a valid reason (**LGC §111.093**).

If the county plans to use "Anticipation Notes" to fund expenditures for which the notes may be used, then usually a recommendation for such use is recommended by the county auditor (**CIV ST Art. 717w**)

OTHER AREAS OF RESPONSIBILITY AND AUTHORITY

Local Government Code §117.051

The commissioners' court may authorize the county auditor, or the county treasurer if there is no county auditor, to place funds in time deposits with the depository selected by the county.

Local Government Code §117.054

The county is entitled to receive a part of the interest earned on the trust funds placed in time deposits under §117.051. The amount to be received is to be determined by the county auditor and transferred to the general fund of the county. The amount must be reasonably related to the accounting and administrative expenses incurred by the county in handling the funds.

Local Government Code §152.051

By definition the county payroll officer means the county auditor unless the commissioners' court has designated another county official to issue paychecks to county personnel.

Local Government Code §154.045

If a notice of indebtedness has been filed with the county auditor evidencing the indebtedness of a person to the state, the county, or a salary fund, a warrant may not be drawn on a county fund in favor of that person, or an agent, or an assignee, until the person owing the debt is notified that the debt is outstanding and the debt is paid.

> **Note: The Attorney General for Texas has ruled that delinquent taxes are not to be construed to be a debt.**

Local Government Code §155.002

A request for a payroll deduction is to be in writing, submitted to the county auditor, and state the amount to be deducted and the entity to which the amount is to be transferred. The request will remain in effect until the county auditor receives a written notice of revocation signed by the employee. A payroll deduction can not exceed the amount stated in the request.

Local Government Code §156.003

The county is authorized to establish and operate an electronic fund transfer system and the county auditor shall establish the procedures for operating the system.

Local Government Code §237.004

In a county where the sheriff has the authority to regulate alarm systems, and a permit is required to operate an alarm system as prescribed by commissioners' court, then the sheriff may permit the county auditor to collect and report such fees.

Local Government Code §291.006

A county official or an agent, deputy, or employee of a county official may not operate a private business on public property unless the person: files a report of receipts and disbursements with the county auditor on or before the 1st of January each year; the person must maintain accurate and detailed records; and, all records of receipts and disbursements are to be available for the county auditor to review. The net operating income from the operation (on a cash basis) is to be delivered to the county treasurer at various intervals along with required reports.

Government Code:

From time to time, it may be necessary for a county auditor to seek clarification concerning the statutes. The county auditor has several sources for such clarification including, but not limited to:

(A) Other county auditors
(B) the texas association of County Auditors
(C) The Local Government Division of the State Comptroller's Office
(D) Oral information from the Attorney General's Office
(E) The County's Independent Legal Counsel
(F) The County or District Attorney

Government Code §402.042

(a) On request of a person listed in subsection (b), the attorney general shall issue a written opinion on a question affecting the public interest or concerning the official duties of the requesting person.

(b) An opinion may be requested by:

(8) a county auditor, authorized by law. In practice, The County Auditor must first request an opinion from his County or District Attorney. If the County or District Attorney refuses to issue an opinion or if the County Auditor disagrees with the opinion, the County Auditor may then send a request for formal written Attorney General's Opinion

Government Code §441.161& 441.162

The County Auditor shall be a member of the local government records committee.

Government Code §511.016

(a) Each county auditor shall provide the commission (On Jail Standards) with a copy of the auditor's annual audit of the county jail's commissary operations and a copy of the annual financial audit of general operations of the county jail. The county auditor shall provide a copy of an audit not later than the 10th day after completing the audit.

Water Code §60.204

In counties where there is a navigational district organized under Article III, Section 52, or Article XVI, Section 59, of the Texas Constitution, the county auditor is to insure that each year the commission that controls the district set aside 5% of its gross income from operations for the promotion and development fund. The county auditor is not required to audit the disbursements from the fund, but is entitled to a monthly report.

Water Code §61.174

In counties where there is a navigation district created under Article III, Section 52, of the Texas Constitution, the county auditor is required to be the auditor for the district, and in this capacity make such additional reports and perform such accounting services in addition to those now required by law as may be reasonably incident to the proper conduct of the business of the district.

Water Code §62.158

In counties where there is a navigation district created under Article XVI, section 59, of the Texas Constitution, the county auditor (or an independent certified accountant) is required to make an audit of the revenues of the district. The audit is to be performed by March 1 each year and reported to the commission for the district.

Water Code §63.224

In a "self liquidating" navigational district, the county auditor (or a certified independent auditor) is required to perform on an annual basis an audit of all books maintained by the district, and to report the results of the audit to the district as soon as practical after January 1.

Civil Statutes Article 1676

(a, b) In counties having a county auditor and in which the population is not less than 75,000, nor more than 83,350, and in which there are navigation districts, water improvement districts and water control and improvement districts, the county auditor shall not exercise any control over the financial affairs of these districts. But, annually between July 1 and October 1 the county auditor is required to conduct audit of all books and accounts maintained by the district. Each month the districts will file with the county auditor a monthly report for the preceding month.

(c) In order for a county to issue "revenue anticipation notes", it must have a county auditor. Such notes may only be issued upon the recommendation of the county auditor. The county auditor is responsible for identifying the anticipated revenue, the expenses to be paid, and is responsible for seeing that the notes are paid in accordance with this article.

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THE COUNTY AUDITOR'S OVERALL STATUTORY RESPONSIBILITIES

Counties With A Population of 500,000 or More:

Local Government Code §151.903

The county auditor is required to prescribe the forms and systems to be used by elected officials and department heads for documenting departmental personnel and requests for pay.

Local Government Code §157.002

The commissioners' court may adopt a rule to provide medical care, hospitalization and compensation for various county employees and other related parties. Such a rule is subject to the approval of the county auditor.

Local Government Code §157.902

The district judges in a county may by a majority vote establish rules to be applied to hours of work and the related benefits of probation officers, court reporters and county auditors. Once the rule is adopted it must be evidenced as an order of the court and filed for record.

Local Government Code §159

A county or district officer or a candidate for a county or district office shall file a financial statement and other disclosures as required by Subchapter A with the county auditor.

Local Government Code §291.005

The commissioners' court has the authority to direct and control employees hired to operate and maintain the county courthouse and criminal court buildings. Such personnel so employed will be done so in writing and approved annually by the commissioners' court. The number of employees appointed under this section is subject to the approval of the county auditor.

Counties With A Population of 600,000 or More

Local Government Code §293

The commissioners' court may put before the voters the proposition to establish a Building Authority. The purpose of the authority is to review existing county facilities, develop plans for the expansion of county facilities, perform surveys, create preliminary plans, and to make recommendations to the commissioners' court. In the event the authority is created, the county auditor shall appoint a comptroller to the authority subject to the approval of the board and the commissioners' court (**§293.025**).

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
DEGREES OF AUDITING

INTRODUCTION

The concept of auditing seems to have been developed some 5,500 years ago in Mesopotamia. Records have been recovered that appear to be financial records, reflecting business transactions. Beside the numbers in the clay tablets are small "tick marks" to indicate that the transaction was complete and verified. The system required one scribe to summarize the transactions and another to verify to the assertions. Thus was the concept of division of duties established.

Egyptians and Persians are found to have had a similar system for verifying the accuracy of the records maintained by trading caravans. A third position was added - the witness. An independent party hired to witness the exchange of goods and money and to document same. The Greeks followed their lead in adopting control over finances, but the businessmen did not trust freemen to carry out the duties of verification and attestation. They used slaves, because they could be tortured to reveal the truth. They did not trust the question and response logic. The merchant took the audit process seriously.

The county auditor is familiar with the fact that there are two kinds of auditor - the independent external and the internal auditor. The external auditors must satisfy themselves that an entity's financial statements are reasonable and presented in conformity with generally accepted accounting principles. They should also verify that said principles have been applied consistently, when compared to the previous year. The external auditor extends an assurance on an entity's financial statements and the results of operations. This manual does not deal with the external auditor. Its focus is the same as the merchants of old - the internal auditor.

The county auditor performs an audit function with the primary responsibilities as follows: the reviewing of accounting controls for adequacy; generating, classifying and reporting accounting information; and keeping management informed on all financial and non financial matters that may be observed. While the external auditor's focus is very general and very broad, the county auditor's focus is very narrow and comprehensive. The external auditor is more interested in financial matters, while the county auditor is not only interested in the financial matters, but also the operational controls within the system. The external auditor is not over concerned with fraud and his level of materiality is usually set very high. On the other hand the county auditor is vitally concerned with all manner of waste and fraud, whatever the source and however small the size.

The word "audit" has several meanings. In the dictionary, an audit is defined as the following:

1. An examination of records or accounts to check their accuracy.
2. An adjustment or correction of accounts.
3. An examined and verified account.
4. A hearing.
5. To register for and attend a college class without receiving academic credit.

The etymology of the word "audit" comes from the Middle English adaptation of the Latin auditus, "a hearing," from the past participle of audire, "to hear." The modern word "auditory," whose definition is "of or pertaining to the sense, the organs or the experience of hearing," comes from the same etymology. Hence, the definitions and etymology of "audit" primally meant to "to hear." "Hear" has several definitions in the dictionary which are meaningful in defining the word audit, as shown herein:

1. To hear by the ear.
2. To listen attentively.
3. To learn by the speech of others; be told.
4. To listen in an official, professional or formal capacity.
5. To be informed; learn.

The word "hearing" also has definitions which parallel the meaning of the word "audit," as follows:

1. An opportunity to be heard.
2. A preliminary investigation of an accused person.
3. A session, as of an investigatory committee, at which evidence is gathered, assessed and testimony is taken from witnesses.

In the definitions of "hearing," forms of the word "investigate" appear in two of the three definitions presented. To follow the trail of meaning even further, the definitions of "investigate" are presented below:

1. To observe or inquire into in detail.
2. To examine systematically.
3. To search into.

The etymology of "investigate" is from the Latin in + vestigare, "to track" or "trace," which is further derived from the Latin vestigium, which means "a trace" or "footprint."

Initially, the primary root behind the word audit, "to hear," sounds passive. However, when taken in conjunction with the root words and "cousin" words of audit, it becomes a word which connotates planned and systematic action. For purposes of this discussion "hear" must be expanded to mean all that is received by the auditor's ears, eyes and brain - it must include listening to the auditee, observing the auditee's actions, perusing the auditee's files and documentation, and analyzing and assimilating everything the auditor hears and sees. In short, it means much more than the dictionary definition of audit as "an examination of records or accounts to check their accuracy". An audit must be an all encompassing quest for knowledge about nearly all aspects of the auditee. In fact, the auditors of the county auditor's office should know as much or more about many areas of the auditee's office than the actual auditee. How can an audit be accomplished by an auditor who is not very knowledgeable about the auditee? It cannot.

In addition to the aforementioned, an audit must have "results." An auditor must not only gather knowledge and information, he must report the results of his findings, analyses and recommendations in the form of the conclusions he states in his workpapers, exit interviews and audit reports. This is called the "attest" function of an audit. The dictionary definitions of "attest" are as follows:

1. To affirm to be correct, true or genuine; corroborate.
2. To certify by signature or oath; affirm in an official capacity.
3. To bear witness; give testimony.

An auditor must attest as to the auditee's records and reports. See section 6 of this guide for additional comments on communicating audit results.

TYPES OF AUDITING

The *Standards For Internal Auditing,* promulgated by the Institute of Internal Auditors do not require that internal auditors be aware of everything, nor does it require the auditor to insure against all noncompliance or wrongdoing that might be occurring. The *Standards* do require that a reasonable and competent person will apply reasonable professional care in developing compliance standards for review and analysis.

The county auditor and available staff must be aware that there are risks involved in auditing any county office or activity. There are stones to be turned over and caves that must be entered. Each assignment does not require the auditor to have extensive awareness of all possible pitfalls, but it does require the auditor to exhibit professional competence. The layman often does not appreciate the problem that exists when the same person that makes deposits, posts accounts receivable, and does the bank reconciliation. Department heads

often do not understand the problem when the same person that orders goods is the same person that receives the goods, acknowledges receipt and issues checks for payment thereof. It falls to the county auditor to perceive the risks associated with these activities.

Thus, the county auditor is constantly confronted with potential risks that may be present in any assignment, and is vigilant to install safeguards that will prevent losses and eliminate risks. The internal auditor will structure an audit program for the assignment based on a preliminary evaluation of the adequacy of both the internal and financial controls, the effectiveness of internal monitoring, and management competence. Audit programs will vary from office to office, depending upon the controls present.

SAMPLE AUDIT TYPES WITH DEFINITIONS

Accounting-Oriented Audit - is an audit that focuses on accounting transactions and attests that the recordation of those transactions and related financial activities within an organization's financial statements are correct and proper. Some times this is referred to as a "transaction audit," where a transaction is followed from the source document, through the ledgers, to the financial statements.

Balance Sheet Audit - is an audit conducted at a specific point in time that confirms the existence of supporting detail for every item on a fund's balance sheet. All elements of the balance sheet should be properly classified. A balance sheet audit is not concerned with the proper classification of revenues or expenditures, but is concerned that the ending balances are reconciled and there is subsequent activity to support the balances.

Compliance Audit - is an audit that reviews the offices financial transactions and operating controls. Evaluation should reveal that the department is properly managing county assets and complying with established minimum standards.

Comprehensive Audit - is an audit that would involve the evaluation of all the activities within a governmental office. This form of audit would go beyond just the financial evaluation.

Financial Audit - is an audit that would concentrate on the economic activity of an office (or an entity), the measurement of this activity; the reporting of this activity, and the accounting of this activity.

Management-Oriented Audit - the purpose of which is to help managers to be better managers; i.e., achieve goals, create efficiency, and reduce costs. The results of this form of audit will make the manager more aware of their environment, and the effectiveness of their office.

Operational Audit - The goal of this audit is a full, comprehensive understanding of the activities, systems and controls of a particular office. The results of the audit allow the auditor to better evaluate the unit's efficiency and effectiveness within economic parameters. This is sometimes referred to as a "performance audit".

Participative Audit - is a form of audit used that enlists the aid of the auditee once an area of concern has been isolated. Its purpose is to get the manager involved in the problem solving.

Program Audit - is a review of an entire program to determine if the desired benefits are being achieved. This is not to be confused with an audit of continuing activities.

Transaction Audit - is an audit that reviews the documentation and support surrounding a selected type of transaction. Usually the auditor will test various attributes associated with a selected form of transaction.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
THE AUDIT FUNCTION OF THE COUNTY AUDITORS OFFICE

OBJECTIVE

The objective of the auditing function within the county auditor's office is to assist other county offices in the effective discharge of their responsibilities. To this end the auditing process furnishes them with analyses, appraisals, recommendations, counsel and information concerning the activities reviewed. The audit objective includes the promotion of effective controls and reasonable costs. The desire of the county auditor is to see that adequate financial control procedures are implemented at all levels.

SCOPE

The scope of duties with regard to auditing encompasses examination and evaluation of the adequacy and effectiveness of the organizations' system of internal controls. It includes review of the quality of performance carrying out responsibilities established by statute and commissioners' court. These duties include, but are not limited to:

- Reviewing the reliability and integrity of financial and operational information, and the means used to identify, measure, classify, and report such information.
- Reviewing the systems established to ensure that the organization is in compliance with state laws and regulations and county policies, and to ensure that reporting is proper and adequate.
- Reviewing the means used to safeguard assets, and verifying the existence of those assets.
- Reviewing the economy of use and efficiency of use with which resources are employed.
- Reviewing operations or programs to ascertain whether results are consistent with established objectives and goals and whether the operations or programs are being carried out as planned.

RESPONSIBILITY AND AUTHORITY

The county auditor functions under those statutes established by the State of Texas and those policies as established by the commissioners' court. The office's responsibility and authority should be defined in a formal written document. It should be clear in the document that the county auditor has no authority over the activities audited.

The county auditor is responsible for to serving the organization in a manner that is consistent with the standards established by the State of Texas. This includes coordinating internal audits, providing reliable, timely accounting and reporting of financial activities while maintaining high levels of independence and adherence to ethical standards.

INDEPENDENCE

The county auditor should be independent of the activities being audited. The county auditor should be able to carry out work freely and objectively. Independence allows the county auditor to render impartial and unbiased judgments essential to the proper conduct of the audit. Independence is achieved in that the county auditor is appointed by the district judge(s) and therefore should not respond to political influence. The county auditor is responsible for maintaining an independent mental attitude. The county auditor is not responsible for drafting operational policies or procedures, or for designing and installing operating systems for a county office. But, the county auditor is responsible for developing fiscal and financial policies and procedures.

The county auditor must insure that a high level of objectivity is maintained at all times in performing an audit.

REPORTING

The county auditor shall report all findings observed and documented within the scope of the audit. All deficiencies should be noted in the report, and recommendations for the correction of those deficiencies made. The preliminary report should be reviewed with the auditee, with all matters of concern being evaluated. Comments by the auditee are requésted. All material deficiencies must be reported.

For additional information regarding reporting, please see Chapter 6.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
QUALITY CONTROL IN THE COUNTY AUDITOR'S OFFICE

As the county auditor's office assumes greater responsibility for evaluating the financial status, compliance status and internal controls of the county's operations and financial reporting, there is a need to assure that the quality of the reports and examinations is consistent and reliable. The county needs to be assured that the desired safeguards are in place and functioning. There is a need for independent, objective and reliable analyses and assurances.

As a general term, "quality assurance" is usually understood to mean the process of objective reviews of general effectiveness and compliance with relevant policies and standards. The idea of quality assurance encompasses a broad range of objective reviews, from routine supervisory functions to independent appraisals. Such reviews may encompass various levels of responsibility and detail (**Statement of Internal Audit Standard 4).**

Thus, the office of the county auditor should establish and maintain a quality assurance program to evaluate the operations of the audit and accounting functions that are a responsibility of the office. The office should document that each function of the office is being carried out in an objective, independent, and competent manner, with integrity and consistency. Standards should be established so that the county auditor's required level of assurance is met. Quality assurance is essential to maintaining an internal auditing department's capability to perform its functions efficiently and effectively.

All accounting functions and practices of the county should conform to and follow those standards established as generally accepted accounting principles (GAAP). Ensuring that principles and standards promulgated by the Governmental Accounting Standards Board (GASB) are adhered to is the responsibility of the auditor's office. In addition the office of the county auditor should insure that the financial reports prepared by the county meet the minimum standards set by the GASB and the State of Texas.

Regarding the audit function, the office of the county auditor should establish some standards as minimal assurances, such as the following:

Regarding general standards:

- All examinations are to be made by person(s) having adequate technical training, who are proficient auditors.
- In all matters relating to an assignment, an independent mental attitude must be maintained.
- Due professional care is to be exercised in the performance of the examination.

Regarding field work:

- Work is to be adequately planned and all assistants are to be properly supervised.
- There is to be a proper evaluation of internal controls for establishing a basis for reliance, and for deciding the extent of work to be done on the underlying transactions.
- Sufficient, competent evidential matter is to be obtained through inspection, observation, questions and confirmations to provide the county auditor with a reasonable basis for its report regarding the financial status and internal controls of the auditee.

Regarding reporting:

- The report shall meet the minimum standards established by State statutes and GASB pronouncements.
- The report shall identify those areas perceived to be deficiencies, those areas that do not comply with State statutes, and those areas that are not being accounted for consistently.
- The report shall be informative and adequate disclosures should be provided for the reader.
- The report shall not contain an expression of opinion regarding the financial activity or operations of the auditee, but it should contain a clear-cut indication of the character of the auditor's examination and the degree of responsibility that is being taken.

During assignments and engagements within the county auditor's office, conflicts are bound to arise. It is responsibility of the county auditor, and first assistants, to insure that the rules of conduct established for the office are adhered to, that conflicts of interest and biases are avoided, so as not to compromise the integrity of the work being done.

One of the issues confronting the county auditor is that of independence. The county auditor probably cannot obtain an absolute degree of independence, but the office could probably achieve sufficient independence concerning matters they audit to accomplish objectivity - in both fact and appearance. The auditor can render a free, unbiased, unrestricted report as to the state of matters as they exist.

Regarding evidence:

The working papers developed during the audit should document the work done, and should provide a record of the findings. The working papers should contain a written audit program referenced to the working papers. Working papers should contain the objective, scope and results of the audit. The working papers should contain sufficient information so that supplemental oral explanations are not required. The working papers should be legible, containing both adequate summaries and lead schedules. Information regarding matters not material to the audit being performed should not be included in work papers. The work papers should contain documentation that supervisory review has taken place (see Chapter 5.3).

Other Issues:

Another pervasive factor in the accounting and auditing function is that of materiality. It has been defined as "... the magnitude of an omission or misstatement of accounting information that, in the light of surrounding circumstances makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the inclusion or correction of the item." (Statement of Accounting Concepts 2). Whether an item is material will depend on the circumstances surrounding it. Common sense will normally lead us to a *de minimis* rule. The county auditor should establish a standard that is consistently followed by all staff concerning materiality.

A county auditor should make sure that all work is reviewed regularly. The review can be done internally with the use of supervisory personnel within the county auditor's office, or it can be done externally with the assistance of independent auditors.

All personnel employed within the county auditor's office should practice a high level of due care. All irregularities need to be investigated, evaluated and documented. Errors could exist because of omissions, clerical oversights or the ignorance of the auditee. Then again they could occur due to intentional wrong doing and collusion. All errors, irregularities and illegal acts should be reported.

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AUDIT GUIDE
QUALITY CONTROL IN THE COUNTY AUDITOR'S OFFICE

The county auditor should establish policies and procedures for the hiring of personnel. Reasonable assurances that employees possess appropriate characteristics allowing for competent performance of duties should exist. Accordingly, the policies and procedures should establish reasonable assurance that personnel hired will have the opportunity to advance, and also the ability to assume additional responsibilities.

All members of the county auditors office should be provided the opportunities and the encouragement to fulfill minimal levels of professional development through continuing education. Insuring that all personnel have adequate education and knowledge, provides assurances for the fulfilling of assigned responsibilities. No staff member should be assigned to accounting or auditing tasks for which they do not have proper technical training.

The county auditor should establish minimal standards and objectives for the preparation of internal working papers. Workpapers used consistently throughout various audits (cash counts, bank reconciliations, confirmations etc.) should be standardized. All workpapers should be reviewed. All items included in the report should be adequately documented in the workpapers. It needs to be remembered that the workpapers are public documents.

Conformance to established standards is no guarantee that each accounting or audit function is being accomplished. All work must be well planned, supervised and evaluated to assure that all available resources are properly and economically deployed. The review function, both in the office and in the field, should be conducted regularly and all assignments should be monitored. The written report is the best documentation of the review function.

Finally, the accounting and auditing functions of the county auditor's office should be reviewed each time the county has an external financial audit performed. Good quality control in the auditor's office will allow the external auditors the ability to place some reliance on the reports already prepared internally, and consequently reduce the level of materiality in their evaluation and scope.

COUNTY AUDITOR'S OFFICE BASIC INTERNAL QUALITY CONTROL SYSTEM

- **INDEPENDENCE**

Personnel will exhibit and maintain a high level of independence at all times, and conduct their daily work professionally.

- **ACCEPTANCE AND CONTINUANCE**

When associated with another county department or interacting with county employees and elected officials, high degrees of integrity and respect are always required, and should be expected in return.

- **ENGAGEMENTS AND ASSIGNMENTS**

No personnel should be assigned, nor should they accept assignments for which they are not technically competent..

- **SUPERVISION**

All work that is performed will comply with professional standards of quality. All work should be reviewed by the county auditor or an external auditor retained by the county.

- **REPORTING**

All audit and review assignments should be followed with a written report as to the results, findings, suggestions, and personnel involved within fifteen days after the completion of field work. The final report should be presented to the auditee within thirty days after the completion of field work.

- **PROFESSIONAL DEVELOPMENT**

The county auditor's office is responsible for always maintaining high levels of trained proficiency, so that all assigned responsibilities and duties are carried out efficiently and effectively.

- **CONSULTATION**

All members of the county auditor's office are expected to seek consultation and assistance from their immediate supervisor. No question or problem should be viewed as improper or insignificant. Problems are issues looking for solutions.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
DEVELOPMENT OF AN AUDIT PLAN
GENERAL DISCUSSION

Very few Texas county auditors have an overabundance of time and manpower. It is even probable that some county auditors simply cannot find the time to carry out their audits to the level required by the statutes or at least to their own professional level of comfort.

Each county auditor wants to be able to say "I am effective at discharging my audit function," but many carry around a little nagging feeling that there are some things which need to be done which just are not getting done. Maybe there are some audits the auditor knows need to be done, but he spends so much time putting out fires and chasing rabbits that they just do not get done.

There is an old adage which proclaims that "work always expands to meet time available to complete the task." This simply means that if a man has four hours to dig a five-foot deep hole in soil which has many interesting fossils, it will probably take him four hours to dig the hole. However, if he knows that an enemy tank will be coming in thirty minutes, and that he must dig that five-foot hole to hide in, it will probably take fifteen minutes for him to dig the hole.

In a CPA firm, each audit has a time budget in which each section of the audit is allocated a set amount of time for completion. The time allocated to each audit section is based primarily on the professional judgement of the audit manager. The audit manager reviews all available documentation concerning the client and allocates audit time, giving more time to high risk areas and less time to low risk areas. Thus, the audit team has a guide telling each member how much time they can afford to spend on each audit section, and it will help keep them from getting "bogged down" on cash, accounts receivable, inventories, etc.

That same discipline that the audit manager uses in the CPA firm should be used on each audit performed by the county auditor, but more importantly this discipline should be employed on a macro basis. That is, the county auditor should assess the relative risk existing for each one of the officials or entities which should be audited, and then allocate the available audit manhours based on the relative risk determined to exist in each.

The rest of this chapter discusses this process in more detail by covering the following areas:

- Determination of the audit universe
- Internal control evaluation
- Analytical review
- Risk assessment
- The audit plan
- The audit calendar

Each county auditor must realize that perfecting the audit planning process is a time consuming process. Adequate internal control documentation and risk assessment for each auditee office in the entire county could take up to two or three years. It is not a short-term project, but once it is set up it will be an invaluable asset which will ultimately save time and, more importantly, it will help establish priorities so that the most important jobs are assuredly completed.

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AUDIT GUIDE
DEVELOPMENT OF AN AUDIT PLAN
DETERMINE THE AUDIT UNIVERSE

Before an assessment of relative risk between auditees can be done, the audit universe must be defined - what are the entities/functions which must be audited routinely? To a large degree the audit universe is defined by the statutes, but it will probably be necessary to add to those required by statutes to adequately discharge what others may perceive as the County Auditor's duty. On page 3.2-1 is an example of the audit universe of an actual very large Texas county, which can be used as a reference in developing an audit universe for any Texas County. A substantial number of the auditees listed on 3.2-1 will not apply to many counties.

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DEVELOPMENT OF AN AUDIT PLAN
DETERMINE THE AUDIT UNIVERSE
SAMPLE OF A METROPOLITAN TEXAS COUNTY AUDIT UNIVERSE

911 Emergency Network
Accounts Payable
Administrative Services-Budget Office
Agricultural Extension Services
Alberti Fund (Special Revenue)
Appraisal District
Sport Facility Lease Agreements
Auditor's Management Information Systems
Auto Usage
Bank Reconciliation
Bonded Debt Compliance
Building Superintendent
Cash Management & Investments
Cash Management Quarterly
Children's Protective Services
CIMS
Commissioner, Pct. 1
Commissioner, Pct. 2
Commissioner, Pct. 3
Commissioner, Pct. 4
Constable 1
Constable 2
Constable 3
Constable 4
Constable 5
Constable 6
Constable 7
Constable 8
Construction Activity-Engineer
Construction Activity-Flood Control
Construction Activity-Flood Control
Budget & Coordination
County Attorney
County Clerk-Election Division
County Clerk-Trust Funds
County Clerk Management Info System
CSC-Business Office
CSC-Fiscal Services
CSC-Management Info System
CSC Building
CSC Probationer Programs
CSC Residential Facilities
CSC Restitution Funds
Data Services & Communications
Debt Management
Department of Education
District Attorney
District Clerk-Child Support
District Clerk-Civil/Family Intake
District Clerk-Jury Fund
District Clerk-Juvenile Court System
District Clerk-Post Trial Division
District Clerk-Subscriber Access
District Clerk-Trust Funds
Domestic Relations
Economic Development
Emergency Medical Services/Rural Fire Dist.
Engineer
Fee Audit
FEMA Funds
Fire Marshall
Flood Control District
General Fixed Assets
Grant Monitoring Subrecipient
Grant Programs
Health Department-Environmental Health
Health Department-Animal Control
Health Department-Consumer Health
Health Department-Grant Activities
Health Department-Personal Health
Hospital District(Detail on Separate List)
Housing & Comm Dev-Housing Assistance
Housing & Comm Dev-CDA Activities
JIMS
JP 1-1
JP 1-2
JP 2-1
JP 2-2
JP 3-1
JP 3-2
JP 4-1
JP 4-2
JP 5-1
JP 5-2
JP 6-1
JP 6-2
JP 7-1
JP 7-2
JP 8-1
JP 8-2
Juvenile Probation
Law Library
Marriott Management Services Corp.
Mental Health and Mental Retardation
Mosquito Control
Parking Facilities
Payroll
Payroll Handouts
Pct. 1 Concession Agreement
Pct. 2 Concession Agreement
Pct. 3 Concession Agreement
Pct. 4 Concession Agreement
Private Industry Council
Pollution Control
Port Authority
Pretrial Services
Public Libraries
Purchasing Recycling Program
Right of Way
Risk Management
Race Park
Seized and Forfeited Assets
Sheriff-Bail Bond & Forfeitures
Sheriff-Booking, Classification & Release
Sheriff-Civil Service Commission
Sheriff-Commissary
Sheriff-Cost Bill Tracking System
Sheriff-Inmate Programs and Trust Accounts
Sheriff-Jail Operations
Sheriff-Reserve Deputies Program
Sheriff-Technical Service Bureau
Sheriff-Office of Emergency Management
Sheriff\Constable Contract Services
Social Services
Tax Assesor Management Info Systems
Tax Assessor & Substations
Testing for External Auditors
Toll Road Authority
Treasurer
Treasurer-Quarterly Cash Count
Vehicle Maintenance
Vendor Documentation
Workers Compensation Quarterly Review

CSC - Community Supervision & Corrections

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
DEVELOPMENT OF AN AUDIT PLAN
INTERNAL CONTROL EVALUATION IN GENERAL

Adequate internal control evaluation is the backbone of the audit planning process. It is an extensive process which involves different information gathering and documentation techniques. It is the primary basis for assessing the various risks related to each auditee.

An entity's system of internal controls consists of policies and procedures, **actually functioning as designed,** established by management to:

- Provide reliable information with which to produce financial statements and to manage the department.
- Safeguard assets and records.
- Encourage adherence to prescribed policies, procedures, laws and regulations.
- Promote operational efficiency.
- Accomplish established objectives and goals.

Internal controls are not a guarantee that the above mentioned goals will be accomplished, because a system of internal controls should be cost effective. The cost of operating such a system should not outweigh the benefits and even the best system will fail without strict adherence by both management and staff and clear communications.

Internal controls must **function as designed**. The existence of good control may be concluded by an auditor when an auditee's checks require dual signatures. But the auditor may not know that one of the signers routinely presigns all of the blank checks in the checkbook "because it is more convenient." So much for that control!

See Chapter 4 of this manual for a complete discussion of the internal control evaluation process.

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DEVELOPMENT OF AN AUDIT PLAN
ANALYTICAL REVIEW

In addition to internal control evaluation, analytical review provides additional depth in helping assess the risk level of each auditee. Analytical review is the process which examines information about the operations of the auditee in order to find significant or unusual relationships, changes and fluctuations.
If something unexpected or unexplained is discovered it could point to a potential problem area, or at least be a symptom of trouble. The analytical review process often presents revelations which might be missed through other auditing and review techniques.

Basically, analytical review allows the auditor to quit examining trees and leaves and makes him stand back and look at the forest as a whole. Does the forest look like a forest should look? Are there "holes" in the forest where they should not be, or conversely are there trees where "holes" should be? Has the forest grown since last viewing? Has the mix of the trees changed, indicating a new direction for the forest? The logging company was denied access to the forest, but there are new clear cut areas. Why?

An analytical review of a Justice of the Peace office might examine and compare data over several months and years including, but not limited to, areas such as the following:

- Citations filed in the court
- Number and amount of fines collected
- Fines dismissed
- Number of receipts issued
- Number and amount of refunds issued
- Number of employees
- Staff turnover
- Cash collections compared to check collections

The above data can then be examined with questions such as the following being asked:

- Does the data reveal fluctuations or changes which were not expected.

- Were there any expected fluctuations or trends which did not occur? An example of this would be an expected increase in fees, when the legislature mandates an increase in a fee or requires a new fee. If a new fee increases the total fee structure 20%, did the total fee collections increase 20% (of course changes in volume of fee collections have to be considered, also)

- Are there seasonal fluctuations? Are they reasonable, expected or unexpected?

- Has there been an increase in the ratio of checks collected compared to cash collected, and yet the total dollar amount and number of collections remains flat? That could indicate a theft of cash.

Section 5.4-6 of this audit guide presents an additional discussion of analytical review.

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AUDIT GUIDE
DEVELOPMENT OF AN AUDIT PLAN
RISK ASSESSMENT

INTRODUCTION

If there were no risks in county finance, audit time could be allocated according the size of the various county offices. For example the county tax office would require considerably more audit resources than a one-man justice of the peace office. However, it is entirely possible that an adequately staffed and well-run, large office generates less risk than a disorganized, poorly-run small office that keeps poor records.

The county auditor must identify and evaluate the relative risks associated with each auditee over which he has responsibility.

Audit risk can be broken down into several components, as will be shown below. But, business risk (aka. job security risk for the county auditor) should be remembered. This is the risk that the county auditor will suffer loss or injury from litigation or adverse publicity in connection with an audit for which he was responsible. An auditor who does his job in a credible, professional manner and who exhibits high standards in professional judgement and documentation will have much more to back himself up when the rocks start flying. Doing the job right is no guarantee that all the problems will be detected, but at least it can demonstrate that the standards of the profession were met. Also, always remember the auditor's prayer.

"Lord, if something is out there, please let me find it.
And, if it is there and I don't find it, don't let anyone else find it."

Remember, the worst way for a county auditor to find out about problems in the county is to read about them in the newspaper. A county auditor can minimize the risk of such nasty little surprises by doing his job and paying attention to what is going on in the county buildings.

RISK COMPONENTS AS PROMULGATED BY THE AICPA

The AICPA's Statement of Auditing Standards No. 47 , states that audit risk consists of three components - inherent risk, control risk and detection risk.

"Inherent risk is the susceptibility of an account balance or class of transactions to error that could be material...assuming that there were no related [offsetting] internal controls. The risk of such error is greater for some balances or classes than others. For example, calculators are more susceptible to theft than is an inventory of [asphalt]. Accounts consisting of amounts derived from accounting estimates pose greater risks than do accounts consisting of relatively routine, factual data. External factors [can] also influence inherent risk."

"Control risk is the risk that error that may occur in an account balance or class of transactions and that could be material...[and] will not be prevented or detected on a timely bases by the internal control structure. Control risk is a function of the effectiveness of the internal control structure. Some control risk will always exist because of the inherent limitations on any control structure."

"Detection risk is the risk that the auditor's procedures will lead to the conclusion that error in an account balance or class of transactions that could be material...does not exist, when in fact such error does exist. Detection risk is a function of the effectiveness of auditing procedures and of their application by the auditor. It arises partly from uncertainties that exist when the auditor does not examine 100 percent of an account balance or class of transactions and partly because of other uncertainties that exist, even if 100 percent...has been examined. Other uncertainties arise because an auditor might select an inappropriate auditing procedure, misapply an appropriate procedure, or misinterpret audit results. These other uncertainties can be reduced to a negligible level through adequate planning, supervision and conduct of the county auditor's office with appropriate quality control standards."

OTHER RISK FACTORS

In addition to the risk factors set out by the AICPA, other risk factors should be considered.

- Frequency and quality of auditing by the county auditor and any outside agencies.
- Size and complexity of the auditee's operations.
- Employee attitudes and morale in the auditee's office.
- Managerial attitudes and morale in the auditee's office.
- External factors such as the press, controversy, politics, etc.

Other risks may be identified in different counties, depending on the circumstances.

Frequency and quality of auditing is a factor over which the county auditor has control. If the auditee is rarely or poorly audited, the risks are substantially greater than for an auditee who is examined professionally with regularity. Regular auditing tends to discourage fraud and makes employees more careful, it tends to discover fraud and errors sooner, before they have a chance to become significant, and it often leads to improved operations through audit generated recommendations.

Size and complexity of the auditee's operations is a factor to consider. Generally, the larger and more complex the operations of an office, the more risk there is that errors or fraud can be material, simply because there is more financial exposure.

Employee attitudes and morale can be a serious risk factor. In an office where the employees are truly overworked, or just think they are overworked, or even if they are unhappy for other reasons, it is easy for them to rationalize setting aside some of the cash receipts for themselves - after all, they "are not getting paid enough for this job, and other people make more for the same job." Also, poor attitudes and morale can lead to the shortcutting of procedures, sloppiness and make the system more prone to error.

Managerial attitudes and morale can also be a serious risk factor. Risk factors relating to managers/officials can include, but not be limited to the following:

- A manager/official who delegates excessively, without appropriate monitoring.
- A manager/official who insists on doing everything himself, especially if this compromises internal control.
- A manager/official who is not an effective communicator - he knows what needs to be done, but somehow cannot get his staff to follow his directions (because they cannot understand what he wants).
- A manager/official who lacks apparent integrity.
- A manager/official who is overly oppressive and keeps the employees immobilized from fear.
- A manager/official who would trust every one of his employees with his credit card.
- A manager who is "nice," but does not have a clue as to what he is supposed to do.

External factors can produce high visibility risk in some situations. For example if the press is pursuing a problem in an official's office - the county auditor better find it before they do! Other pressures could include special interest groups, political races and controversial county programs.

SAMPLE RISK ANALYSIS SCHEDULES

A simple format is shown below to help the county auditor assess the risk of a particular auditee and to document that he went through the necessary steps to accomplish that assessment.

EVALUATION OF RISKS AND PROBLEM AREAS
JUSTICE OF THE PEACE, PRECINCT 1
DATE OF EVALUATION: XX/XX/XX

RISK FACTOR	COMMENTS
FREQUENCY AND QUALITY OF AUDITING	
Frequency of examinations	Meeting statutory requirements
Quality of examinations	Generally OK, except Jan-Mar not as thorough due to time spent on another special project audit.
Audit planning	OK. Need to review and amend audit program to cover the new changes in the computer system.
ADEQUACY OF INTERNAL CONTROL	
Segregation of duties	Adequate, except for dismissals.
Safekeeping of assets	No separate change drawers, and access to change drawers is unlimited.
Sound policies & procedures	Adequate, except that one clerk who receives cash also initiates dismissals. Judge approves the dismissals on a "batch basis" by initialing a list at month end.
Adherence to policies & procedures	Good in significant areas
SIZE AND COMPLEXITY OF OPERATIONS	
Complexity	Relatively complex - second only to tax assessor
Dollar volume	$1.7 million annually $6-9,000 per day
Frequency of remittances to Treasurer	Daily
Amount left in office overnight	Averages $2,000. Kept in locked safe.
Number and volume of refunds / dismissals	Dismissals are increasing in relation to prior years.
Seasonal fluctuations	Greater volume in summer with tourist traffic on interstate.
EMPLOYEE ATTITUDES / MORALE	
Subjective / Objective Observations	Degenerating. Clerk who handles dismissals is irritable and refuses to let anyone else do her work.
MANAGEMENT ATTITUDES / MORALE	
Subjective / Objective Observations	JP delegates excessively and infrequently monitors office.
EXTERNAL FACTORS	
Press, political, etc.	JP's opponent in upcoming race has been making open records requests concerning dismissal volume.
SUMMARY OF RISK	HIGH RISK

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RISK ASSESSMENT

The preceding evaluation format is a sample only and does not include all the factors which may need to be included in a actual assessments. The following is a sample form which can be used to pull the risk evaluations together for an evaluation of the relative risk of each auditee. Objectivity is paramount in this assessment process.

RELATIVE RISK RANKING BY OFFICE
DATE OF EVALUATION: XX/XX/XX

1=LOWEST RISK & 6 =HIGHEST RISK	AUDITEE					
RISK FACTOR	A	B	C	D	E	F
FREQUENCY AND QUALITY OF AUDITING						
Frequency of examinations	2	6	1	3	6	4
Quality of examinations	1	1	3	3	2	1
Audit planning	1	1	2	3	2	1
ADEQUACY OF INTERNAL CONTROL						
Segregation of duties	2	2	5	1	2	1
Safekeeping of assets	1	2	2	1	1	1
Sound policies & procedures	3	2	4	1	1	1
Adherence to policies & procedures	1	1	6	1	1	1
SIZE AND COMPLEXITY OF OPERATIONS						
Complexity	6	2	2	5	3	4
Dollar volume	6	1	1	5	4	5
Frequency of remittances to Treasurer	1	5	6	1	1	1
Amount left in office overnight	4	5	6	1	1	1
Number and volume of refunds / dismissals	1	1	6	1	1	2
Seasonal fluctuations	4	1	2	5	1	2
EMPLOYEE ATTITUDES / MORALE						
Subjective / Objective Observations	2	2	5	1	2	1
MANAGEMENT ATTITUDES / MORALE						
Subjective / Objective Observations	2	2	6	1	2	2
EXTERNAL FACTORS						
Press, political, etc.	3	1	6	1	1	2
TOTAL OF RANKINGS	40	35	63	34	31	30
RELATIVE RISK RANKINGS	5	4	6	3	2	1

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DEVELOPMENT OF AN AUDIT PLAN
THE AUDIT PLAN

The first step in developing an audit plan and audit calendar is to determine the available resources to carry out the audit plan. The example below shows how this can be determined in a relatively simple matrix. The matrix lists each resource's available total hours and reduces those hours for vacation, holiday and non-audit hours. Note that the county auditor's non-audit hours are significant because of the time which must be devoted to other duties such as the budget, personnel matters, financial and general ledger management, continuing professional education, etc. Note also, that other county auditor's staff such as accounts payable staff, data entry personnel, support staff, and payroll staff are not included in the analysis, but an all-inclusive plan could be set if the county auditor so desired.

ANALYSIS OF AVAILABLE AUDIT HOURS

NAME	TITLE	AVAILABLE TOTAL HOURS	HOLIDAY HOURS	VACATION HOURS	NON-AUDIT HOURS	AVAILABLE AUDIT HOURS
Smith	county auditor	2,080	(80)	(80)	(1,200)	720
Jones	Audit Manager	2,080	(80)	(80)	(320)	1,600
Thomas	Auditor	2,080	(80)	(120)	(60)	1,820
Perkins	Auditor	2,080	(80)	(80)	(60)	1,860
Wilson	Auditor (PT)	1,040	(40)	0	(20)	980
TOTAL		9,360	(360)	(360)	(1,660)	6,980

After the county auditor determines the available manhours which can be devoted to audit work, he should prepare a table of auditees, the relative audit risk assigned to each, and the total audit hours which can (or must, because of statute) be invested in each. Note that just because audit risk on a particular auditee is high, a large amount of time should not be arbitrarily assigned to its audit. Instead, **the time assigned should be based upon the amount of time it should take to complete the steps in an audit program which has been designed for this auditee's particular risk factors.**

ALLOCATION OF AVAILABLE AUDIT HOURS

AUDITEE	AUDIT RISK	TOTAL HOURS	SMITH	JONES	THOMAS	PERKINS	WILSON
Tax Assessor	High	1420					
County Clerk	Moderate	1,080					
District Clerk	Low	700					
Justice of the Peace, Pct. 1	High	960					
Justice of the Peace, Pct 2	Low	720					
Sheriff - Commissary	High	680					
Sheriff - Bail Bonds	Low	620					
Juvenile Probation	Moderate	400					
CUSHION FOR REQUESTED OR FRAUD AUDITS	N/A	400					
TOTALS		6,980	0	0	0	0	0

The above matrix is a layout example, in no way indicates that the hours allocated are reasonable for any given auditee

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AUDIT GUIDE
DEVELOPMENT OF AN AUDIT PLAN
THE AUDIT PLAN

After the allocation of available audit hours is made to the auditees, the matrix should be completed by assigning the available audit hours to the resources as is shown in the matrix below. Note that there is an "auditee" called "cushion for requested or fraud audits". This is includable at each county auditor's option, but it is recommended. If there is a cushion and it is not needed (fat chance of that happening), the time can be used for other productive projects such as system design improvements in auditee offices. If there is no cushion and a special project raises its ugly head, the audits which have been assigned specific hours based on their risk will end up being shorted - and that can compromise the whole audit plan.

ALLOCATION OF AVAILABLE AUDIT HOURS

AUDITEE	AUDIT RISK	TOTAL HOURS	SMITH	JONES	THOMAS	PERKINS	WILSON
Tax Assessor	High	1420	185	500	580		155
County Clerk	Moderate	1,080	75	200		580	225
District Clerk	Low	700	30	100	570		
Justice of the Peace, Pct. 1	High	960	80	200	670		10
Justice of the Peace, Pct 2	Low	720	10	100		430	180
Sheriff - Commissary	High	680	50	180		300	150
Sheriff - Bail Bonds	Low	620	10	120		400	90
Juvenile Probation	Moderate	400	40	40		150	170
CUSHION FOR REQUESTED OR FRAUD AUDITS	N/A	400	240	160			
TOTAL		6,980	720	1,600	1,820	1,860	980

Note that the "audit risk" in the preceding matrices is either "High," "Moderate" or "Low." Alternatively, a county auditor could use more than three classifications, and they could be expressed quantitatively (i.e. rank the risk on a scale of 1 to 10). Any approach is acceptable as long as the results are clearly justifiable with supporting documentation.

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AUDIT GUIDE
DEVELOPMENT OF AN AUDIT PLAN
THE AUDIT CALENDAR

SPREADSHEET TYPE AUDIT CALENDAR

Creating the audit calendar takes the audit plan one step further by determining when the audits are planned. An audit calendar such as the one presented below is based upon the total hours for each auditee as determined in the audit plan creation, and is sufficient for counties which do not have a large audit staff.

COUNTY AUDITOR'S OFFICE
COMPREHENSIVE AUDIT DEPARTMENT CALENDAR
Fiscal Year 9/30/XX

	TOT	MONTH OF FIELD WORK											
AUDITEE	HRS	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
Tax Assessor		2	1B	1A	2	1A	1C	2	1A	1A	3	1A	1A
	1,420	284	28	14	284	14	142	284	14	14	314	14	14
County Clerk		1A	2	1C	1A	3	1A	1A	2	1A	1B	2	1A
	1,080	10	216	110	10	241	10	10	216	10	21	216	10
District Clerk		1A	1B	2	1A	1A	2	1A	1A	3	1A	1C	2
	700	8	16	140	8	8	140	8	8	146	8	70	140
Justice of the Peace, Pct. 1		2	1A	1A	2	1C	1A	3	1A	1A	2	1B	1A
	960	212	10	10	212	22	10	231	10	10	212	11	10
Justice of the Peace, Pct. 2		1B	3	1A	1A	2	1A	1A	2	1A	1A	2	1C
	720	10	164	8	8	160	8	8	160	8	8	160	1B
Sheriff - Commissary		1A	1B	2	1A	1A	3	1A	1C	2	1A	1A	2
	680	8	9	150	8	8	164	8	9	150	8	8	150
Sheriff - Bail Bonds		2	1A	1A	2	1A	1A	2	1A	1A	3	1A	1A
	620	138	8	8	138	8	8	138	8	8	142	8	8
Juvenile Probation		1A	3	1B	1A	2	1A	1A	2	1A	1C	2	1A
	6,956	12	78	16	12	70	12	12	70	12	24	70	
TOTAL	6,568	682	529	456	680	531	494	699	495	358	737	557	350

LEGEND

1A Limited Scope
1B Limited Scope with payroll handout
1C Limited Scope with fixed asset inventory
2 Full scope audit
3 Full scope audit with surprise cash count

123R5W/AUDGUID1.WK1

Note that the audit calendar above does not include the "cushion" time allowed in the audit plan.

DATABASE ORIENTED AUDIT CALENDAR

Counties with larger audit staffs will probably find that an audit calendar built from a database approach will be more useful and flexible. Here is an example of the fields which could go into each record of such a database.

AUDITEE	MANAGER NAME	MANAGER TIME BUDGET
AUDIT TYPE	SENIOR NAME	SENIOR TIME BUDGET
SCOPE	STAFF NAME	STAFF TIME BUDGET
AUDIT PERIOD	DATE OF LAST	TOTAL TIME BUDGET
FIELD WORK DATE	AUDIT REPORT	
AUDIT RISK		

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DEVELOPMENT OF AN AUDIT PLAN
THE AUDIT CALENDAR

With the preceding information in a good database software package many useful reports can be generated to aid in management of the audit team. Several off-the-shelf, user-friendly database software packages exist and any of them would work well for this purpose.

The following are some examples of the types of reports which can be generated from such a database:

- A report of all the audits assigned to a given audit staff employee. This could help in identifying overcommittment or slack time for that employee.

- A report of all of the scheduled audits for a given auditee.

- A report showing the dates of the last audit reports for all auditees.

- A report of all of the audits and who is assigned to each. This would be an excellent mechanism for communicating schedules a year in advance.

- If fields were included in the above database structure for actual time expended on each audit, a report of actual results could be printed at year end to serve as a baseline for the next years audit calendar.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
INTERNAL CONTROL EVALUATION
GENERAL DISCUSSION OF INTERNAL CONTROLS

WHAT IS INTERNAL CONTROL?

Internal accounting controls are designed to provide reasonable, but not absolute, assurance that:

- Transactions are executed in accordance with management's general or specific authorization.
- Transactions are recorded as necessary to:
  - Permit accurate preparation of financial reports.
  - Maintain accountability for assets.
- Access to assets is permitted only in accordance with management's authorization.
- Recorded accountability for assets is compared with the existing assets at reasonable intervals.

The broad sweep of this definition includes much more than just simple procedures. It includes the methods by which an entity's management delegates authority and assigns responsibility for all functions, but reaches further than that. The absolute most important component of a good internal control system is managements embracing of, wholehearted desire for and dedication to internal control. If management does not care about good internal control it will not exist. That is the reason it is as important to review and document not only the internal control system, but also the internal control "environment" (i.e., is it taken seriously, is it something to which the auditee just pays lip service, or is it simply ignored or even abhorred).

The second most important component of the internal control system is frequent, high-quality auditing by the county auditor. If the county auditor does not take the audit function seriously, county offices are less likely to take their own internal control responsibilities seriously.

Key objectives of intenal controls are:

- To help prevent errors and fraud
- To help safeguard assets
- To help protect those who do not commit errors and fraud
- To help insure that transactions are consistent with the law and management directives
- To detect errors, fraud, and violations of law and management directives as early as possible, before they become serious problems

It is also important to stress that when errors and fraud are found, especially if they are found early, may be an indication that the internal controls are working and that someone and/or something is doing their job. Of course, one should always find out why the error or fraud occured, and determine whether changes need to be made. However, do not automatically assume that major changes need to be made - maybe the system was working and that is why the problems were brought to light.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
INTERNAL CONTROL EVALUATION
GENERAL DISCUSSION OF INTERNAL CONTROLS

GENERAL CHARACTERISTICS OF GOOD INTERNAL CONTROL

There are many offices in a county, operating under different conditions, in different locations and with varying numbers of personnel and volumes of transactions (transactional volume should be measured two ways - number of transactions and total dollars handled). Before delving into a detailed analysis of any office, it is important to step back and "look at the big picture" of what should exist in any and all offices if they are to have an effective internal control system. An effective internal control system begins with:

- **A logical plan of organization**, which establishes clear lines of authority and responsibility, and segregation of duties..

- **An adequate structure** consisting of well defined procedures.

- **Personnel with ability, experience and ATTITUDE** sufficient to enable them to perform satisfactorily the responsibilities assigned to them.

One of the maxims of internal control is that no one person should handle all phases of a transaction from beginning to end. A **logical plan of organization** (except for "one-man" offices), requiring two or more persons to participate in each transaction, causes the work of one employee to serve as proof against the work of another. The principle is that a segregation of duties should add to the efficiency of operations and produce warning signals when an error, whether accidental or intentional, is introduced into the accounting process. The three key duties which should always be divided are the authorization (approval), recording and custodial (physical handling) duties.

An **adequate accounting structure** should always be set forth in a policies and procedures manual, or less desirably, memorandums from management. Every entity, large or small, has a body of established methods of initiating, recording, summarizing and reporting transactions. If accounting procedures are clearly stated in writing, the policies set by management can be enforced efficiently and consistently. Uniform handling of like transactions is essential to the production of reliable accounting records, and consistency is possible only when definite patterns for processing routine transactions is communicated clearly to all employees.

An adequate accounting structure should also include well designed documents and forms which are controlled by serial numbering (some forms such as receipts and checks should always be prenumbered at the printer). The inventory of prenumbered forms should always be controlled by someone other than the employee who should be using them in the system.

The need for having personnel with the ability, experience and attitude to do their assigned job is self-explanatory and self-evident, but it should be pointed out that attitude is probably the foremost of the three attributes. A less experienced, less skilled employee with a good attitude can contribute much more to a system that an experienced, highly skilled employee with a poor attitude.

LIMITATIONS OF INTERNAL CONTROL

There are inherent limitations that should be recognized in considering the potential effectiveness of any system of internal control. In the performance of most control procedures, errors can result from misunderstanding of instructions, mistakes of judgement, carelessness, a "don't care" attitude, other personal factors, or managements lack of commitment to internal controls. Internal controls are like seat belts; it is one thing to just have seat belts in a car and quite another matter to use them. Too many people hold their shoulder strap down with their hand whenever they go by a law enforcement officer, and then release them when the officer is out of sight. It is the auditors duty to determine that the internal

controls, **as documented**, actually function as designed; that they are more than just "window dressing." Just having prenumbered receipts is not sufficient, for example. Inventories of unused receipts must be controlled, receipts must be issued in sequence, copies must be given to payors, voided originals must be kept and accounted for, and they must be matched to deposits. Without all of these occurring, prenumbered receipts are not worthless, but are certainly not as effective as they could be.

Internal control procedures, depending on the strength of segregation of duties can be circumvented by collusion. Additionally, some of the offices in counties are "one-man" offices making segregation of duties difficult. In these small offices it is important to institute compensating controls such as mandated vacations of up to one full week and more frequent and extensive audit procedures such as heavy confirmation work and more frequent surprise cash counts.

The concept of **reasonable assurance** recognizes that:

- the cost of a control should not exceed the benefits to be derived, and
- the evaluation of costs and benefits requires estimates and judgements by those charged with the design of the internal controls.

Common sense must be utilized in designing and implementing internal control systems. They should be tight enough to provide the desired degree of assurance and protection, but should not be so cumbersome as to interfere unnecessarily with the real function of an office. It does not make sense to spend $500 to protect $5.

DOCUMENTATION OF THE INTERNAL CONTROL SYSTEM

Internal control systems can be documented by a number of methods. Narratives, questionnaires, flowcharts and segregation of duties analyses are the most common and effective methods. Each of the methods has its own strengths and weaknesses. Generally speaking, a combination of all or some of the methods is usually necessary in order to adequately document a system. The "package" of one or all of these methods is combined in the permanent audit file under the catch-all phrase "system documentation" or "sysdoc", for short. A detailed discussion of each of these methods is follows in this chapter.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
INTERNAL CONTROL EVALUATION
INTERVIEWS

Interview technique is critical to a successful sysdoc interview. The most effective method is to ask the interviewee to tell all their functions, and then have them do a "walk-through" of each function. A "walk-through" consists of the interviewee starting at the initiation point of a transaction and explaining all the documentation, processing, approvals, and reports or forms generated, all the way through to the culmination of a transaction. Frequently it may be necessary to link interviews with two or more persons in order to obtain a complete walk-through. For example, in order to perform a walk-through on the expenditure cycle for supply purchases in a county, it could be necessary to interview the Purchasing Agent, County Judge personnel, county auditor, accounts payable personnel and County Treasurer personnel. Each has responsibilities in the expenditure cycle, such as order initiation, receiving and controlling the products ordered, processing invoices, purchase orders and receiving documentation, approving for payment, entering transactions, signing checks and reconciling the bank statement.

During a walk-through, the interviewer should never ask leading questions (questions phrased whereby the average man on the street would know what the auditor wants to hear). For example, if an auditor is conducting an interview with a cashier and wants to know what happens to the original of each receipt, the auditor should ask the interviewee the disposition of the original, blue copy and pink copy of the receipts. If an auditor asks the interviewee "Does each payor always get the original receipt?," most interviewees would know the "correct" answer should be yes - and that is frequently the answer the auditor should receive, even if in reality the payor receives the original receipt only 10% of the time. Many people who are being audited want to please the auditor, and sometimes tell the auditor what they think the auditor wants to hear, rather that the reality.

In doing a walk-through it is also important to let the interviewee "ramble" to some degree since they may provide the auditor with valuable information he might miss otherwise. One quick way to squelch an interviewee's information flow is to make judgmental comments such as "that is a bad procedure" or "instead of doing "x", you should do "y"). The main goal in the interview process is to determine the system as it is represented to exist - the time for professional judgements and suggested improvements to the system should come later. Having said that, it is also the auditor's responsibility to gently guide the interview so it does not get too far off course. There is a delicate art to guiding the interview in the needed direction without causing the interviewee to become defensive or start withdrawing - remember, auditors are frequently perceived as a threat.

Each time an interviewee, refers to any type of documentation, reports, forms, logs or journals, the auditor should request to see these and obtain copies of each, preferably ones which contain live data, as well as blank forms.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
INTERNAL CONTROL EVALUATION
INTERVIEWS

The best way to get the information necessary for a complete and adequate sysdoc is by interviews. It is usually best to begin with an entrance interview of the elected or appointed official, then interview the supervisors and, finally, interview the personnel who actually do the work. It is not unusual to find that there is a disparity between what management thinks employees do and what they really do.

The elected or appointed official should be able to provide the auditor with the basic office organization chart (either on paper or verbally). From interviewing the official, the auditor should be able to determine the official's attitude toward internal controls, the official's personal involvement in the day to day operations of his office, and what specific concerns he has, if any, about specific personnel or procedures. **The interview with the official should leave him with the feeling that the auditor is on his side and is there to help protect him as well as the county.** In larger offices try to avoid getting into the office details with the official, unless he wants to do so - instead depend on the supervisors for more detailed information. In smaller offices, however, it may be necessary to get details from the official.

The entrance interview of the official is also the time to establish the "ground rules" for the audit. It is important to get off to a good start with the official by setting ground rules to minimize misunderstandings. The ground rules should address such items as the following:

- Who is authorized to answer the auditor's questions.
- What are the office hours and what are the "crunch hours" when the auditor would unduly interfere with office functions.
- What location would the official prefer that the auditor use for a workplace during the audit.
- Which of the official's staff are available to help the auditor during the audit.

Supervisors in larger offices should be interviewed for more detailed information about "who does what" in their areas of responsibility, and interviews with their personnel should follow. Discrepancies between what an auditor learns from interviewing the supervisor and interviewing the subordinates should be resolved through further discussion with both the supervisor and subordinates.

Professional judgement should be used in determining which subordinates to interview. If there are ten cashiers in an office which perform the same function, there is no need to interview each - just one. The supervisor should be able to recommend the best subordinate to interview. However, there may be situations where the ten cashiers perform the same basic functions, but each has a specialized job they do each day/week/month/quarter. If this is the case, interview all ten cashiers, but only on their specialized duties and only one cashier on the cashier function.

It is critical to take notes during sysdoc interviews and to quickly transpose them into easily readable form immediately after the interview, before they become "cold" to the interviewer. Additionally, it is usually better for the auditee and the auditor if the interview is carried out in segments of no more that 20 minutes per segment. This keeps the auditor from consuming large blocks of the auditee's time, and gives the auditor time to clarify his notes and isolate any questions resulting from the interview.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
INTERNAL CONTROL EVALUATION
INTERNAL CONTROL ENVIRONMENT

INTRODUCTION

An understanding of the environment in which the auditee's system of internal controls operates should be obtained by the auditor. That understanding is the basis for forming an **overall** assessment of the control environment. A documentation guide (see example beginning at 4.3-2-1) is provided to the auditor as a framework for this study and evaluation.

TIMING OF DOCUMENTATION

The internal control environment should be considered in completing the preliminary assessment phase of the study and evaluation of internal controls, as well as during the entire field work phase. It may not be realistic or accurate to try to **completely finish** the documentation guide during the preliminary phases of the audit. The auditor can complete parts of the guide in the preliminary phases of the audit, but should keep the items on the guide in mind, and develop additional or modified comments throughout the field work.

OBJECTIVES OF THE STUDY OF THE ENVIRONMENT

Because of the differences in offices and the various environmental elements, it is not readily possible to measure the significance of each element. However the study and evaluation of the environment allows the auditor to develop an **overall assessment** of the level of **control consciousness** present in an auditee office. The information gathered for this documentation should reflect that broad objective.

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AUDIT GUIDE
INTERNAL CONTROL EVALUATION
REDUCED EXAMPLE INTERNAL CONTROL ENVIRONMENT DOCUMENTATION GUIDE

TEXAS ASSOCIATION OF COUNTY AUDITORS
DOCUMENTATION GUIDE - INTERNAL CONTROL ENVIRONMENT Pg 1 of 2

Auditee:			
Prepared by:	Date:	Updated by:	Date:
Updated by:	Date:	Updated by:	Date:
Updated by:	Date:	Updated by:	Date:
Updated by:	Date:	Updated by:	Date:

1. COMMUNICATION: Consider the extent of formal communications occurring in the office such as written policy statements, codes of conduct, procedure procedure manuals, organization charts, organized informational meetings, etc.

2. MANAGEMENT OVERSIGHT: Discuss management's oversight of setting standards, reviewing (monitoring) performance, and applying corrective and reinforce-ment procedures. Consider the following areas:

a. Managements overall philosophy about controls including their focus on areas of risk

b. The extent to which the accounting system and related system of internal accounting control is documented (i. e. the existence of defined standards).

c. The timeliness of reports produced, reconciliations performed, and corrections to errors detected through the internal control system. Are important things "put-off".

d. The suitability, availability, reliability or even existence of management reports, and the view of management concerning these reports.

e. The extent to which action has been taken historically, in response to audit reports issued by the County Auditor's office

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AUDIT GUIDE
INTERNAL CONTROL EVALUATION
REDUCED EXAMPLE INTERNAL CONTROL ENVIRONMENT DOCUMENTATION GUIDE

Auditee:

3. PLAN OF ORGANIZATION: The plan of organization can vary from office to office according to its size and complexity. Generally organization encompasses checks and balances, quality of personnel, delegation of authority and scope of responsibilities. The plan of organization should provide for segregation of incompatible functions.

4. PERSONNEL ENVIRONMENT: Consider whether standards, policies and procedures exist for selecting, training, appraising and compensating employees.

5. DELEGATION OF AUTHORITY: Consider whether there is a clear understanding of the authority and responsibilities delegated and the relationships individuals have with respect to others in the organization (e. g. as set forth in an organization chart, job descriptions, etc.). Are personnel informed of the policies, procedures, and activities that directly or indirectly affect their individual responsibilities?

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
INTERNAL CONTROL EVALUATION
OFFICE ORGANIZATION CHARTS

Organization charts graphically display the persons/positions in an entity. The county auditor's office should utilize expanded organization charts which shows the title, primary functions and names in the auditee department. An example of an expanded organization chart should be developed for each auditee is presented on page 4.4-2.

In some departments, it should not be necessary to list the details of the primary responsibilities of certain personnel/positions. The following are examples:

- When preparing an organization chart of a County Clerk, the primary responsibilities of the employees who deal with accounting records or cash handling would be presented in detail, but the clerks who simply work with the physical deed filing, indexes, etc. do not need to be set forth in detail.

- When preparing an organization chart of the nonpayroll aspects of a Treasurer's Office it would only be necessary to show the name and position of the payroll clerk; since she doesn't have "treasury" duties, no further information would be necessary concerning that position.

Use care, however, in assuming certain positions/personnel do not handle cash. For example the Sheriff's deputies and District Attorney's investigators primarily perform nonfinancial activities, but they can and do handle large sums of money when they execute arrest warrants involving seizures.

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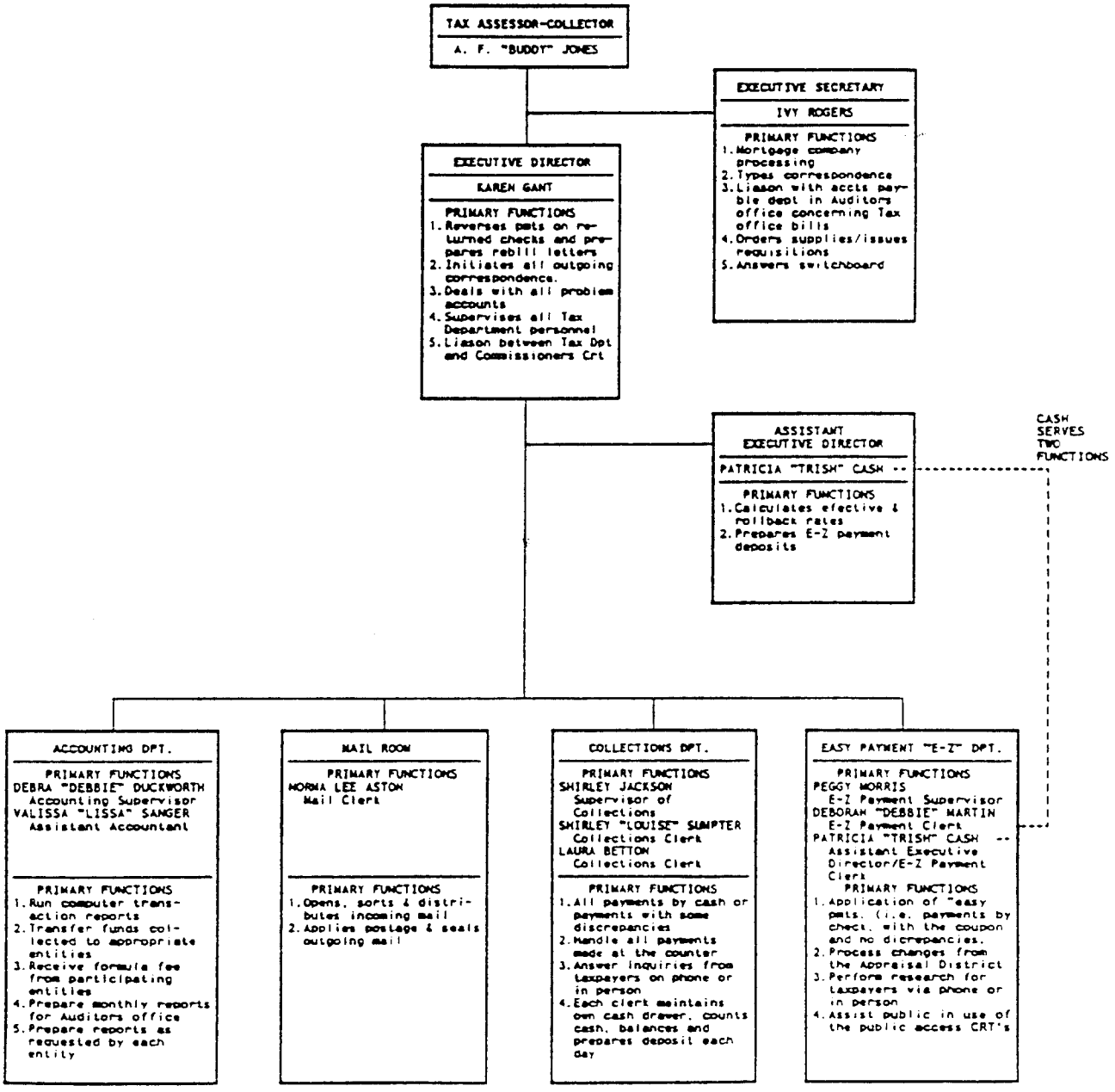
AUDIT GUIDE
INTERNAL CONTROL EVALUATION
OFFICE ORGANIZATION CHARTS
EXAMPLE OF ORGANIZATION CHART



TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
INTERNAL CONTROL EVALUATION
CASH FLOW CONTROL QUESTIONNAIRE

The Cash Flow Control Questionnaire (see 4.5-2-1 through 4.5-2-3) is a tool to assure that key questions concerning the auditee's internal controls relating to cash flow are answered. The questionnaire can be prepared in rough form during the interviews and them a final version can be completed after the interview. The auditor should usually find that it is necessary to go back for follow-up interviews in order to accurately complete the questionnaire.

The first two pages of the questionnaire consist of questions relating to procedures, and the third page is a segregation of duties questionnaire.

The importance of adequate segregation of duties is discussed at the bottom of 4.1-1 continuing onto 4.1-3. The segregation of duties questionnaire is designed to isolate incompatible duties or responsibilities performed by one person.

Ideally, no one should be involved in more than one type of duty. That is, employee A should have "custody" duties only, and should not be keeping any type of books or signing checks. Employee B might be involved in "record" functions such as bookkeeping, posting to logs/journals, taking inventory of unused receipts, etc., but should have no duties involving "custody" or "approval."

On the Segregation of Duties Questionnaire, the auditor should record the names of the persons in the column headings under "Person Performing Duty/Responsible." If the auditor is analyzing a large office such as the tax office, and there are 6 cashiers who perform the same duty, there should be one column marked "cashiers" on the questionnaire instead of writing 6 employees names in 6 different columns. The auditor should then indicate who performs each duty or has the responsibilities listed by placing an "x" in the column of the person (or group of persons such as cashiers) performing that duty or having that responsibility.

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AUDIT GUIDE
INTERNAL CONTROL EVALUATION
REDUCED COPY OF CASH FLOW CONTROL QUESTIONNAIRE - PAGE 1

CASH FLOW CONTROL QUESTIONNAIRE

Office _____ _____ Date _____

Auditor _____

Account Name _____ Bank _____

Account Numbers: Purpose of Account _____

Bank account _____

General ledger _____

Authorized signers:

_____

_____

_____

1. Describe the types of payments for which receipts are issued?

2. Are the receipts computer generated or are they manual receipts?

3. If manual receipts are ever utilized to any degree,

   a. Are they prenumbered?

   b. Are they purchased, issued and controlled through the County Auditor's office?

   c. If manual receipts are temporary (used when the computer is unavailable) describe the what happens to the manual receipt after it is entered in the computer system.

4. Which employees receive money from the public? (For small offices, describe what happens with receipts when the normal cashier is out on vacation, sick leave, lunch or coffee break.)

5. If multiple employees receive money, describe the security and separateness of each "cashiers" accumulated receipts (i.e. separate cash drawers/boxes, lock security, etc.).

6. If multiple employees receive money and they utilize computerized receipts, describe their password security and procedures to assure accountability (i.e. common knowledge of each others passwords, leaving terminals unattended, etc.)

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AUDIT GUIDE
INTERNAL CONTROL EVALUATION
REDUCED COPY OF CASH FLOW CONTROL QUESTIONNAIRE - PAGE 2

CASH CONTROL QUESTIONNAIRE - Page 2

7. What is the office's policy concerning employees cashing checks out of change funds or accumulated undeposited cash receipts?

8. Describe the method of accounting for all receipts issued and who is responsible for this accounting.

9. Describe how receipts are reconciled to deposits and who accomplishes the reconciliation.

10. Describe the procedures when a receipt is voided.

11. How often are deposits made at the bank and how does the money get to the bank?

12. Where is undeposited cash kept

    a. On breaks and lunch times?

    b. Overnight, if not deposited each night?

13. Describe the physical security for the checkbook.

14. Describe the security of any check signing paraphanelia (stamps and signature plates)

15. Are dual signatures required on all checks?

16. Is the bulk of the receipts in cash, checks or money orders?

17. If the office receives receipts in the mail,

    a. Who opens the mail?

    b. Are cash receipts listed by the person opening the mail?

    c. If "b" is yes, what is done with the list?

    d. Are receipts mailed to the senders?

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AUDIT GUIDE
INTERNAL CONTROL EVALUATION
REDUCED COPY OF CASH FLOW CONTROL QUESTIONNAIRE - PAGE 3

TEXAS ASSOCIATION OF COUNTY AUDITORS
SEGREGATION OF DUTIES QUESTIONNAIRE

Auditee:			
Prepared by:	Date:	Updated by:	Date:
Updated by:	Date:	Updated by:	Date:
Updated by:	Date:	Updated by:	Date:

Place an "x" in the column of the person performing the duty or having responsibility		Person Performing Duty/Responsible								
Duty/Responsibility	Function Type	Not Done N/A								
1. Receives money	Custody									
2. Issues receipts	Custody									
3. Opens and lists mail reciepts	Custody									
4. Subsequently compares listed mail receipts to recorded cash receipts	Approve									
5. Balances receipt copies against cash drawer	Custody									
6. Verifies that voided original receipts are kept and reviewed	Approve									
7. Accounts for numerical sequence of cash receipts	Record									
8. Maintains cash drawer	Custody									
9. Prepares bank deposits	Custody									
10. Compares bank deposits receipts to bank stmt.	Approve									
11. Records rcpts in cash received journal/log	Record									
12. Access to inventory of unused cash receipts	Custody									
13. Maintains inventory log of unused cash receipts	Record									
14. Prepares reports of cash received	Record									
15. Responsible for collection of returned cks	Custody									
16. Prepares checks for cash disbursements	Custody									
17. Signs checks 2 signatures required? Yes _____ No _____	Approve									
18. Access to blank checks	Custody									
19. Takes inventory of and orders blank checks	Record									
20. Records disbursements in cash disburesments journal/log	Record									
21. Reconcile bank stmts	Record									
22. Reviews reconciled bank statements	Approve									
23. Posts to receivables	Record									
24. Prepares billings & follows up on delinquencies	Record									
25. Ability to write off any receivables/ dismiss cases	Record									
26. Authority to write off any receivables/ dismiss cases	Approve									
27. Review, approve & sign monthly fin reports	Approve									

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
INTERNAL CONTROL EVALUATION
NARRATIVES
NARRATIVES INTRODUCTION

A written description of the flow of transactions is referred to as a narrative. A narrative describes in a logical progression everything that happens from the initiation of a transaction all the way through to its ultimate disposition. It should address, but not be limited to, the following subjects:

- Who or what initiates a transaction.
- Divisions of tasks into logical, understandable parts.
- Segregation of incompatible duties between personnel.
- Flow of documents from their creation to disposition. The disposition of all copies of a multi-copy document should be addressed.
- Who records transactions.
- Who authorizes transactions and at what points.
- Who has custody and/or access to cash or other assets.
- The degree of independent verification and mathematical checking which occurs.
- What reports are generated.
- Who reviews and/or approves and signs generated reports.

A written description should include identification of the employees performing each step of the function being documented and should indicate in reasonable detail the procedures carried out by those employees.
After the narrative is completed, the auditor should make notations in the borders of the narrative pointing out the internal control strengths and weaknesses present in the described system.

Examples of narratives are included in this guide at 4.6-2-1 through 4.6-2-3 and at the top of 4.7-6-1.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
INTERNAL CONTROL EVALUATION
NARRATIVES
NARRATIVE EXAMPLE

Perm File: Jail Commissary Fund (Fd #165) — *File No: PF165*

Subject: Narrative of ABC Vendors's Procedures — *Date: 10-07-99*

On this date, I went to the ABC Vendors corporate office at 300 2nd St. in Anytown, Texas and visited with Bob Williams, the owner, and Eileen, his office manager. I visited with them concerning their procedures as they relate to the Jail Commissary. They explained their procedures to me, gave me copies of the documents used in their accounting system, took me through the cage in their warehouse containing the commissary inventory and showed me the "counting room" where cash receipts are counted and entered into their computer system. I also spent three hours with Jack, the route man assigned to the main jail commissary, as he made his deliveries to the inmates and collected the cash from them.

*The procedures used in the commissary operation are outlined in the flowchart beginning at **PF165-61-1**, and the forms used in the operations begin at **PF165-70-1**. A narrative of the commissary procedures follows below:*

OVERVIEW: *ABC Vendors Co. contracts with Anytex County (see **PF165-30-1**) to provide commissary services to the inmates of Anytex County in accordance with Local Government Code 351.0415. They receive, fill and deliver orders from inmates and collect the sales price in cash directly from the inmates. The last Friday of each month, they summarize the sales and remit 16.2% to the County as a commission. The procedures governing the commissary operations can be divided into two main categories - **Inventory Cycle** and **Revenue Cycle**.*

INVENTORY CYCLE: *The Inventory Cycle is the basis from which Anytex County's commission is computed. It is a simple system of beginning inventory + inventory received - ending inventory = sales.*

*Inventory: All of the products to be sold to inmates are segregated in a wire cage in the ABC Vendors warehouse. Each Friday, a physical inventory taken and listed on an inventory form such as the one at **PF165-71-2**.*

*Inventory Received: All additions to the commissary cage are listed on a legal pad by the route man in charge of the commissary route (Jack). Each week he summarizes the lists by product and gives the informal Summary of Inventory Received to the office manager (Eileen), who summarizes them by product (see **PF165-71-4**)*

*Product Sales: The sales for the week, by product, are developed by the office manager on the same blank form as is used for inventory, but the quantity she inserts is not the inventory on hand, is the the result of the equation "prior week inventory + inventory received - current week inventory" (see **PF165-71-2**)*

*Commission Statement Generation: The office manager inputs the weekly product sales (**PF165-71-2**) into CompuVend (a software package) on their computer. The last Friday of each month, a monthly commission statement (see **PF165-71-5**) and commission check is generated based upon the weekly product sales input. **After this is generated, the weekly product sales listing (PF165-71-2) is destroyed.***

(Continued)

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
INTERNAL CONTROL EVALUATION
NARRATIVES
NARRATIVE EXAMPLE

Perm File: Jail Commissary Fund (Fd #165) — *File No: PF165*

Subject: Narrative of ABC Vendors's Procedures — *Date: 10-07-99*

(Continued)

REVENUE CYCLE: The Revenue Cycle is comprised of the procedures involved in order initiation, order verification, order filling, delivery / cash collection, counting room activity and sales summarization.

*Order Initiation: On Monday mornings, Tuesday and Thursday, the inmates prepare their own order on a two part form (see **PF165-70-1**) They are told to enter with a black pen the quantity of each product they want, the extended price for each product, and the total purchase price on the bottom of the form below the perforation. These forms are taken up by the jailers, and a representaitve from ABC Vendors picks them up. Deliveries will be made on Monday afternoon (for Monday morning orders, Wednesday (for Tuesday orders) and Friday (for Thursday orders).*

*Order Verification: Immediately upon receiving the order forms, the office manager checks them for mathematical accuracy and for compliance with the $30.00 per order ceiling set by the Sheriff's Department. When the office manager finds errors in math, she corrects them in red pen, on both the upper part of the order form and the lower "stub" portion. After all changes have been made she totals the order forms to develop a control totals for product sales and postage stamp sales for each jail location and records them on her Daily Control Reconciliation (see **PF165-70-2**). After delivery she deductions, the deposit and difference (see "Sales Summarization" following).*

Order Filling: The route man receives the order forms from the office manager, goes to the cage containg the commissary inventory and places the product ordered in individual clear plastic bags for each inmate. When the order for a particular inmate is completed, the route man staples the bag closed and staples the order form (with the stub still attached) to the bag. Bags are then placed in boxes which are labled by tank number in which the inmate resides.

Delivery / Cash Collection: The route man takes the boxes to the jail and goes to each tank. The inmates are called to the window of their tanks one-at-a-time. If an inmate has been released, transfered, has no money, or simply doesn't want his order, the route man can sell the bag to another inmate. If he can't sell it to another prisoner, he tears off the order form from the bag, puts the bag back in the box, and

(Continued)

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
INTERNAL CONTROL EVALUATION
NARRATIVES
NARRATIVE EXAMPLE

Perm File: Jail Commissary Fund (Fd #165) *File No: PF165*

Subject: Narrative of ABC Vendors's Procedures *Date: 10-07-99*

(Continued)

keeps the order form for the undelivered order for the office manager (see "Sales Summarization" below). The route man tells them the total price of their order, collects their money, gives the stub portion of the order form the order form to the jailer responsible for that tank, and passes the bag through the window to the inmate. The only time the inmate doesn't receive his order form with his bag is when he rejects something in the bag. In this instance, the route man keeps the order form, marks the undelivered product on the order form and changes the total on the stub. The altered order form is taken back to the office manager (see "Sales Summarization" below).

The jailers give the stubs to a deputy in the property room, Jane Doe. She accumulates the stubs from all the jailers and delivers them to the County Treasurer's office.

Counting Room Entry: When the route man returns to ABC Vendors he takes the cash to the counting room where it is counted by a money counting machine which also enters the amount counted into the computer network through the CopmpuVend software. CompuVend generates a Daily Cash Report by route (see PF165-70-5). The main jail and minimum security jail are routes 14 and 15, respectively.

Sales Summarization: The route man takes all altered order forms and order forms for undelivered product to the office manager. The office manager enters the dollar amount of the undelivered product and the alterations to her Daily Control Reconciliation (see PF165-70-2, PF165-70-3 and the narrative at "Order Verification" preceding). The next morning she receives the Daily Cash Report (see "Counting Room" above) and records the amount of the cash collected. She then records the difference between the cash deposited and the amount which should have been recorded. She has been instructed by the owner, Bob Chambers, not to look for any differences under $5.00. The batches of altered sales orders and sales orders for undelivered product (PF165-70-3) are destroyed after the Daily Control Reconciliation is completed. The office manager then prepares the Daily Commissary Sales

Recap (see PF165-70-4) which is mailed to the County Treasurer.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
FLOWCHARTS
FLOWCHARTING INTRODUCTION

System flowcharting is one of the three primary methods of documenting an internal control system . A flowchart is a symbolic representation for a system or a series of sequential processes. Preparation of a flowchart enables an auditor to quickly appraise the effectiveness of internal controls and complements the detailed written narratives of procedures or questionnaires. Some basic concepts of systems flowcharting are discussed below:

- The eleven basic flowcharting symbols presented following this introduction are adequate, with the interjection of limited custom symbols, to prepare a complete and effective systems flowchart.

- Every systems flowchart must begin with terminal symbols indicating where the process begins and where it ends.

- The annotation symbol (see no. 12 at 4.7-2-2) is to be used when a further explanation is to be made for a process, document, file, etc.

- Whenever a document is created or comes into a system flowchart it must be followed through to its disposition. It must either be filed, delivered/mailed or destroyed.

No flowchart approach is right or wrong - only adequate or inadequate. Five different auditors should flowchart the same system five different ways, all of which can be "correct". However, there can be five different levels of adequacy. The most important attribute in flowcharting for internal control documentation purposes is a good balance between detail and brevity. A flowchart must provide sufficient detail to show all of the control points without going into so much detail that the reader gets lost in the flow. Look at Flowchart Example One at section 4.7-5 for an example of this concept.

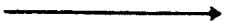
Flowcharts require a considerable investment of time, and their efficient preparation requires careful planning and a thorough knowledge of the system being flowcharted. Before a flowchart can be prepared, the auditor must visit with the personnel involved in the system, get copies of all of the documentation, reports, etc. used or produced in the system, and prepare a detailed narrative of the system. In addition, if a flowchart is going to be prepared with a pencil and template is a good idea to prepare a rough draft of the flowchart initially in order to gain an understanding of the space requirements for each segment and the order of the flow. A rough draft really is not necessary if you are doing the flowchart using personal computer flowchart software (insertions and/or movement of process segments is very easy using the flowchart software). PC based flowcharting software is highly recommended, because they are easier to do initially provide a way to record system changes in the future.

Flowcharting is a skill that must be developed and nurtured, and becomes easier to do each time it is done. The following pages present the twelve most common flowchart symbols, examples of variations in uses of the symbols and two examples of system flowcharts. .

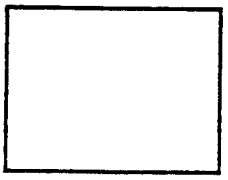
TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
FLOWCHARTS
FLOWCHARTING SYMBOLS

1.

1. **Terminal indicator**
This symbol is used to show the reader where to begin reading the flowchart and where it ends.

2. 

2. **Directional indicator**
This arrow shows the direction of the information flow in the flowchart.

3. 

3. **Process / activity box**
This box represents any processing of documentation or any action carried out by a person.

4.

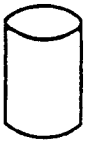
4. **Small document symbol**
This symbol may be used to designate small documents such as checks, cash, cash receipts, etc.

5.

5. **Document / report / printout**
This symbol represents any document, manual report, or computer printout.

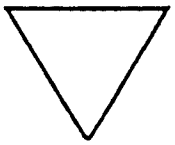
6.

6. **Adding machine tape**
This symbol indicates a calculator tape and is generally used to represent a calculator tape of a batch of documents represented by either symbol #4 or #5.

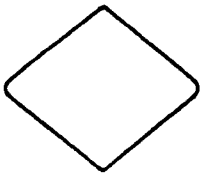
7. 

7. **Computer file processing**
This symbol represents the processing of data through a a computer (mainframe or personal computer).

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
FLOWCHARTS
FLOWCHARTING SYMBOLS

8. 

8. **File / storage / folder**
This symbol represents any type of storage medium such as a file cabinet, file folder, index card box, main memory of a computer, floppy disks, a cardboard file box, or even the trash can.

9. 

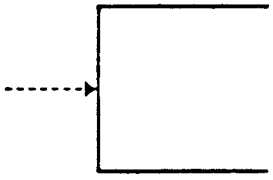
9. **Decision process**
This symbol represents a decision process after which logic "flow" can go multiple directions, depending upon the answer to the question in the decision symbol.

10.

10. **On page connector**
This symbol is used to connect the logic flow between two other symbols from one point on a page to another point on the same page, when it would be cumbersome to use a directional indicator. There must always be two connectors when this symbol is utilized - a "from" connector and a "to" connector.

11.

11. **Off page connector**
This symbol is used to connect the logic flow from a symbol on one page to another symbol on another page. There must always be two connectors when this symbol is utilized - a "from" connector and a "to" connector.

12. 

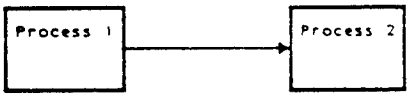
12. **Annotation**
This symbol is connected to any other symbol by a dashed line for further elaboration on the connected symbol. This is convenient when the space inside any symbol is not sufficient to contain all narrative/comments that need to be put into it.

NOTE 1 - The total size, height or width of any of the symbols can be varied to accomodate the text which will be put inside of it. However, the size and contents need to be adjusted only to the point that they will still fit with the "theme" of the chart. The annotation symbol symbol (number 11) is always available when the necessary text will not fit into a symbol of reasonable size.

NOTE 2 - Other custom symbols can be used periodically, when they would be more descriptive and make the chart easier to read. Examples of these custom symbols can be seen in the flowchart examples which follow.

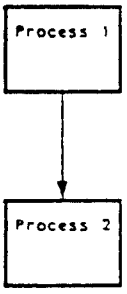
TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
FLOWCHARTS
FLOW INDICATOR EXAMPLES

1.



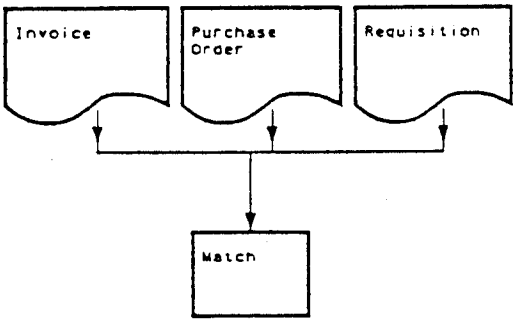
1. This example depicts that, after Process 1 is completed the next step is to do Process 2

2.



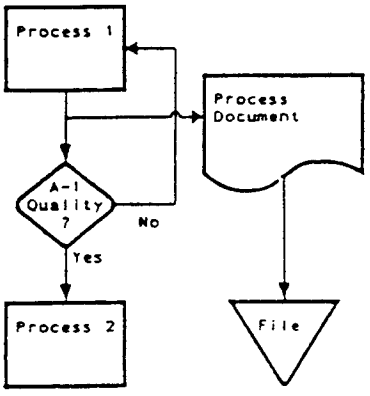
2. Same as number 1 above, except expressed vertically.

3.



3. This example indicates that the data on the invoice, purchase order and requisition are to be matched.

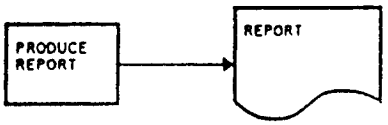
4.



4. This example is presented to show that when directional indicators cross paths the symbol —⌒— should be used to show one line "jumping" over the other, and that they have nothing to do with one another.

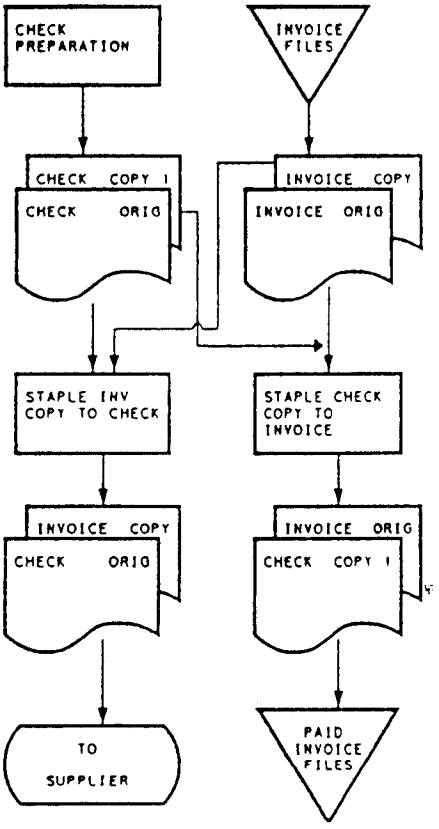
TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
FLOWCHARTS
MULTICOPY DOCUMENT FLOW

1.



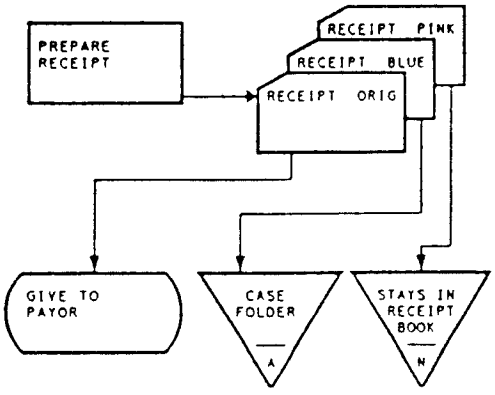
1. This depicts the preparation of a one copy report

2.



2. This depicts the writing of a multicopy check. The original invoice and a copy of the invoice are then removed from the unpaid invoice file. The invoice copy is stapled to the check original and sent to the supplier. The check copy is stapled to the invoice original and filed in the paid invoice file

3.

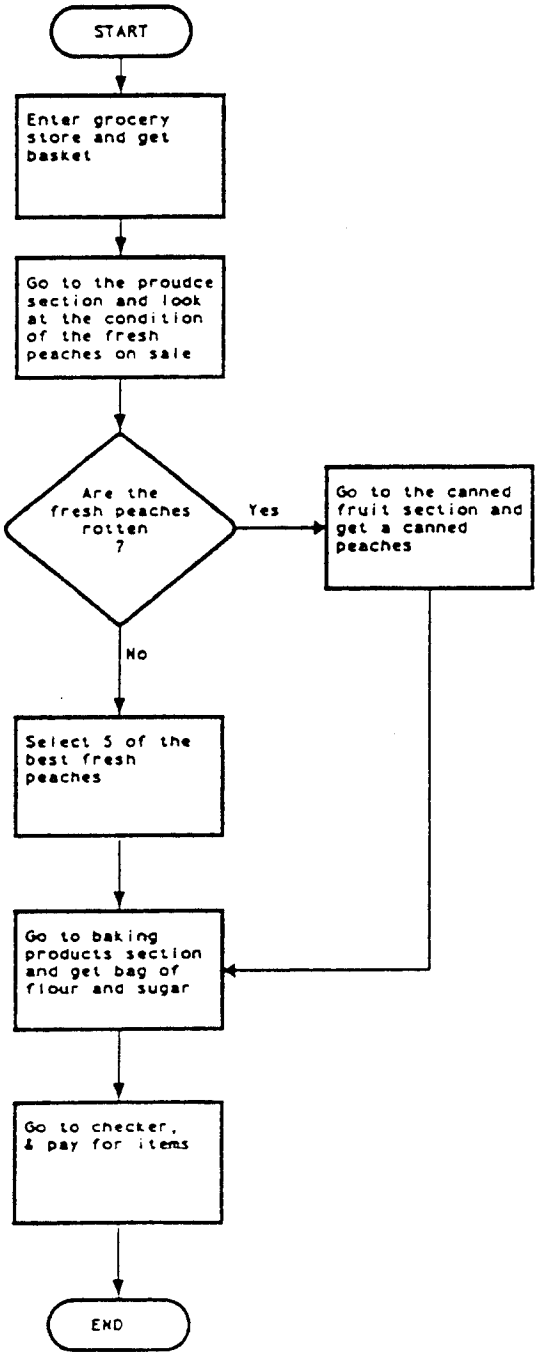


3. This depiction uses the small document symbol to represent the preparation and distribution of a multi-copy receipt. The original receipt is given to the payor, the blue copy is filed in the case file, (alphabetically) and the pink copy stays in the receipt book (since they are prenumbered they are in numerical order). The filing logic, alphabetical(A), numerical(N), date(D), etc.. is indicated by a single letter abbreviation isolated at the bottom of the file symbol.

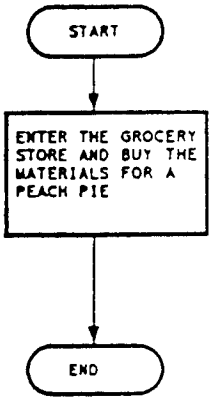
TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
FLOWCHARTS
HOW DETAILED SHOULD A FLOWCHART BE?

You want to make a peach pie, and you have heard that the grocery store is having a very good sale on fresh peaches. However, the last two times they have had such low prices on fresh fruit, the fruit was rotten and old. You decide to go to the store to get the materials for a peach pie, and if the fresh peaches are rotten, you will buy canned peaches.

DETAILED VERSION



CONDENSED VERSION



NOTE: This example shows the varying amount of detail which can be used in presenting a particular action flow. The detailed version could even be expanded further to fill several pages and depict every action including finding the right aisles, shelves and brands, how to write a check to pay for the products, etc. The most important criteria in deciding how much detail to put in a flowchart is the the purpose of the chart. From an auditor's perspective, the purpose is to assess the quality of the internal controls present in a given system. A flowchart prepared for this should be in sufficient detail to present all document sources, document production, control points and document disposition. "Sufficient detail" is shown in flowcharting example two

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
ANALYSIS OF COMPUTER CONTROLS

THIS SECTION WILL BE INCLUDED IN THE NEXT EDITION OF THIS GUIDE

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
GENERAL INTERNAL CONTROL QUESTIONNAIRES

General internal control questionnaires are an excellent method of documenting internal controls and pinpointing internal control weaknesses. Internal control questionnaires are usually designed so that a "no" answer is an indication of a weakness, thereby making it easy to pick up weaknesses while scanning the questionnaire. They also serve as a tool to help insure the auditor does not miss any krtaey control issues.

One strong caveat should be mentioned concerning internal control questionnaires. Generally, the questions are worded where any person of average intelligence would be able to ascertain what the auditor "wants to hear," and in practice it is not uncommon for an auditee to respond to questions read directly from a list in a way that will "please the auditor." The auditor should try to ask questions to elicit the answers without making it obvious what the "correct" answer is. For example it is better to ask the auditee to describe their bank reconciliation process and frequency of the same, rather than simply ask "do you reconcile your bank account monthly" - the answer to that question is usually going to be yes, even if it rarely ever happens in reality, because that answer makes the auditor smile.

Some excellent internal contorl questionairres have been prepared and published by the Texas State Comptrollers Office and they have been reproduced in this guide in APPENDIX 10.5 and 10.6.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
SAMPLE DOCUMENTS

The auditor should obtain copies of sample documents and forms to supplement the previously described internal control documentation techniques. Blank original forms such as a receipt and all its copies enhance the auditor's (and subsequent auditors') understanding of the system. However copies of actual "filled-in" journals, logs, ledgers, reports, worksheets are even more valuable- they add flesh to the skeleton of internal control documentation previously documented.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
ORGANIZATION OF AUDIT FILES
ADMINISTRATIVE FILES

Administrative files of the county auditor's audit department require placement near permanent and current audit files. Administrative files contain past and current audit calendars and a master file of blank audit forms. Current audit calendars show assigned audit dates. Historical calendars show audit schedules. If the Auditor's office is computerized, each auditor has a master file template of blank audit forms. Otherwise, auditors should maintain a supply of blank audit form photocopies.

It is very important for auditors to follow the audit calendar. The auditor discusses any schedule changes with the Audit Manager.

Periodic audit rotations between auditors encourage fresh audit approaches and promote independence. Additionally, rotations provide an opportunity for each auditor to gain a well-rounded understanding of the functions of each County office.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
ORGANIZATION OF AUDIT FILES
PERMANENT FILES

Audit files are divided into two basic categories:

- **Permanent files** - discussed in this subchapter.
- **Current files** - discussed in subchapter 5.1-3-1

Permanent files accumulate data that remains unchanged between audit periods and relates to a particular auditee. Each auditee has a permanent file. The permanent file serves four primary purposes:

- To refresh auditor's memory concerning auditee history.
- To serve as an audit summary for successor auditors when rotation occurs.
- To preserve work papers on items showing few or no changes over time.
- To serve as evidence of auditor's knowledge of the auditee. Knowledge allows the auditor to do an audit meeting auditing standards.

Standard size paper (8 1/2" x 14" or 8 1/2" x 11") is recommended for permanent file documents. If a nonstandard size permanent file document is provided, the auditor uses staples or tape to attach the document to standard size paper.

Each permanent file has a permanent file index as the first page. A reduced version of a standard permanent file index is shown on 5.1-2-4. In accordance with subchapter 5.3-4 standards, each permanent file section has an index number for each file work paper. If work papers are included in a section of the permanent file, the auditor places a check mark in the "included" column of the index. With this procedure, sections without check marks contain no documentation.

Index numbers for divisions of the permanent file are listed below:

10 Office overview

20 Personnel and office organization

30 Contracts

40 Statutes

50 Audit programs

60 Systems documentation

70 Sample forms

80 Audit log

90 Audit reports and responses

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
ORGANIZATION OF AUDIT FILES
PERMANENT FILES

OFFICE OVERVIEW

In narrative form, the office overview describes statutory and nonstatutory office functions. It documents cash receipts and disbursements transactions. Receipt and disbursement descriptions trace funds from receipt to disbursement. For example, a Justice of the Peace collects funds for a Department of Public Safety traffic citation. Overview documentation shows amounts collected and disbursed to other fee officers, County, State or other entities.

PERSONNEL AND OFFICE ORGANIZATION

Data describing personnel and office organization serves two primary purposes. First, an organizational chart with position titles sets forth basic hierarchy of responsibility, accountability and authority. Second, the addition of employee names to the chart helps the auditor and any successor auditors know the employees' position within the organizational structure.

In large offices, stratified organization charts are best. The overview chart might show only the official, department/function heads and department/function descriptions. A separate chart describes each department/function. Smaller offices are adequately presented on one organization chart. (See 4.4-1 and 4.4-2)

This section contains resumes or bibliographies of key employees. The narratives describe the employee's county work experience and length of county employment. Bibliographies describe an auditee's expertise, skills and strengths. Since audit work papers are public record, the auditor's opinion of an auditee's faults is not appropriate documentation. Additionally, employees in the auditee's office may inadvertently read documentation.

CONTRACTS

The permanent file contains photocopies of all auditee office contracts. Contract examples include sheriff and jail commissary contracts, delinquent tax attorney contracts and tax office collection contracts.

STATUTES

Photocopies of Vernon's Civil Statutes or other governmental agencies' official publications addressing fiscal and/or reporting functions of the auditee require placement in this permanent file section. If commissioner's court mandates the function of the auditee, photocopies of minutes describing the order are necessary for proper documentation. Understanding the statutes, not photocopying them, is the key to this section.

AUDIT PROGRAMS

Master copies of full and limited scope audit programs used for the auditee are located in this permanent file section.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
ORGANIZATION OF AUDIT FILES
PERMANENT FILES

SYSTEMS DOCUMENTATION & SAMPLE DOCUMENTS

The systems documentation section, with the sample forms section, usually comprises the bulk of each permanent file. Both sections are critical to documentation of an effective audit and are discussed at greater length in Chapter 4.

AUDIT LOG

An audit log is a summary of audits previously done on the auditee. A reduced example of the form is on 5.1-2-5.

AUDIT REPORTS

Photocopies of issued audit reports and reportable conditions point sheets are included in this permanent file section.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
ORGANIZATION OF AUDIT FILES
PERMANENT FILES
REDUCED SAMPLE OF PERMANENT FILE INDEX

PERMANENT FILE INDEX

AUDITEE:			DATE CREATED: / /
INCLUDED	INDEX #	DESCRIPTION	
	10	Overview of Office	
	20	Personnel and Office Organization	
	29	Personnel and Office Organization - superseded	
	30	Contracts	
	39	Contracts - superseded	
	40	Statutory Items	
	41	Statutes - General	
	42	Fees Required by Statute	
	43	Fees Allowed at Discretion of County	
	49	Statutory Items - Superseded	
	50	Audit Programs	
	59	Audit Programs - Superseded	
	60	System Documentation	
	61	Documentation Guide - Internal Control Environment	
	62	Cash Flow Control Questionnaire	
	63	Narratives	
	64	Flowcharts	
	69	Systems Documentation - Superseded	
	70	Sample Forms	
	79	Sample Forms - Superseded	
	80	Audit Log	
	90	Audit Reports & Responses	
	91	Reportable Conditions Point Sheets	
	95	Audit Reports	
	98	Auditee's Responses	
	100	Other	

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
ORGANIZATION OF AUDIT FILES
PERMANENT FILES
REDUCED SAMPLE OF AUDIT LOG

AUDIT LOG

AUDITEE

TYPE OF AUDIT	DATE FIELDWORK BEGAN	DATE FIELDWORD COMPLETED	DATE REPORT COMPLETED	DATE REPORT RELEASED

CODES FOR TYPE OF AUDIT

LS - Limited Scope Audit
- a. Routine
- b. With Payroll Handout
- c. With Fixed Asset Observation

FS - Full Scope Audit
FSS - Full Scope Surprise Audit (required once per year by statute)
SR - Special Request

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TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
ORGANIZATION OF AUDIT FILES
CURRENT FILES

INTRODUCTION

A current file is required for each audit and contains work papers relating to one audit. The current file serves as the connecting link between auditee's records and auditor's report. In limited scope audits, the file provides the link to the auditor's conclusions.

WORK PAPERS

In discussing standards of field work, the Committee on Auditing Procedure of the American Institute of Certified Public Accountants pointed out "sufficient competent evidential matter is obtained through inspection, observation, inquiries and confirmations to afford a reasonable basis for an opinion regarding the financial statements under examination." In building this evidential matter, auditors prepare work papers. Work papers include all evidence gathered by the auditor to show work done, methods and procedures followed and conclusions reached. In the work papers, the auditor has the basis for the report or conclusion, evidence of the examination and proof of professional care exercised in the investigation.

Work papers must speak for themselves. Complete, legible and systematically arranged work papers are required. No supplementary explanations or interpretations are necessary.

The most important purposes of work papers are as follows:

- To coordinate and organize all audit phases.
- To simplify audit report preparation.
- To substantiate and explain in detail conclusions and findings summarized in the report.

Coordinate and organize all audit phases

Coordination of all audit phases of audit work is achieved through work papers and illustrates proper planning, thought processes and rationales used by the auditor during the audit. An independent third party reviewing permanent and current files should know why the audit was done, why the auditor chose certain audit techniques, how the auditor's conclusions were reached and see the auditor's conclusions.

Simplify report preparation

Work papers are **the source** that simplifies preparation of the auditor's report and conclusions. **Nothing** is found in an audit report without work paper support.

Substantiate the report

To clearly prove the auditor's report, audit work papers must provide evidence of the auditor's compliance with generally accepted auditing standards. The work papers should show adequate planning of the audit, a comprehensive study and evaluation of the auditee's system of internal control, relation of internal control evaluation to the audit program, accumulation of sufficient competent evidential matter to support conclusions and the report.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
ORGANIZATION OF AUDIT FILES
CURRENT FILES

CURRENT FILE INDEX

On 5.1-3-4 of this guide, a reduced copy of sample current file index is presented. The work paper sections presented are as follows:

1	Audit work order
2	Audit program
3	Reportable conditions point sheets
5	Audit report
10	Notes for subsequent audits
2x	Copies of reports generated by the auditee
3x	General ledger analysis
4x	Bank activity
5x	Cash counts
60	Receipts tests
70	Disbursements tests
80	Confirmations
90	Open section
100	Fixed assets
110	Payroll handout

Audit Work Order

At the inception of the audit, the auditor prepares an audit work order. A reduced example is presented on 5.1-3-5. An audit work order shows the auditee, planned audit date, audit type, auditor, auditor comments, time budget and audit review sign-off segment. The audit log section tracks time spent on the audit on a daily basis.

Audit Program

Limited and full scope audit programs of each auditee are located in respective permanent files. When an auditor reaches the planning stages of an audit, he reviews the pertinent audit program and makes necessary modifications. The revised audit program is placed in the current audit file for the pending audit.

Reportable Conditions Point Sheets

Reportable conditions point sheets are documents where audit points are recorded. Audit point examples include control weaknesses, discrepancies, statute violations, etc. At the end of audit, each point is reviewed to decide if the point warrants disclosure in the audit report or only discussion with the appropriate official. All official responses to points are recorded in this section.

Audit Report

Signed audit reports are located in this section. If any significant items are not included on the audit report, a comment sheet should list reasons why the items were not included on the final draft. Audit drafts are inappropriate for this section. Chapter 6 of this guide contains more information concerning writing of audit reports.

TEXAS ASSOCIATION OF COUNTY AUDITORS
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ORGANIZATION OF AUDIT FILES
CURRENT FILES

Notes for Subsequent Audits
Comments for future audits are located in this section. If pending legislation affects future periods, information with effective dates is necessary to correctly audit changes. If specific areas of a department warrant extra attention in a subsequent audit, the current auditor explains the expanded audit procedures. The section is a good place to note any follow up audit procedures from previous audits.

Copies of Reports Generated by Auditee
Auditee generated reports for the audit period are included in this area. Reports to county auditor's office and reports issued to State or other agencies are examples of auditee reports. Cross referencing report data to supporting work papers in other sections is necessary to provide a proper audit trail.

General Ledger Analysis
This section contains a trial balance and work papers analyzing balance sheet accounts. Balance sheet account analysis should cross reference to the trial balance. Account balance detail is required for proper analysis of accounts.

Bank Activity
Bank reconciliations and/or proofs of cash for the audit period are located in this section. Miscellaneous bank transactions reports are also included in this section.

Cash Counts
Cash count work papers are located in this section. Cash counts show the cash count date, cash on hand, required cash balance, auditor's signature, auditee's signature and any variances. Auditors never do a cash count without the auditee's presence. Auditor always have the auditee sign the cash count to verify the return of funds.

Receipts Tests
Cash receipts work papers are located in this section. If sampling is used, complete documentation of sampling procedures is required. (See 5.4-7-8 of this guide).

Disbursements Tests
Cash disbursements work papers are located in this section. If sampling is used, complete documentation of sampling procedures is required. (See 5.4-7-8 of this guide).

Confirmations
Confirmation documentation is located in this section. Documentation includes sampling procedures (see 5.4-7-8 of this guide), confirmation copies, responses, cleared discrepancies and resolved discrepancies.

Fixed Asset Audit
The auditee's fixed asset listing is shown in this section. The auditee is responsible for assets shown on their listing. Work papers show any comments and tickmarks document observation of listed assets.

WORK PAPER CONTENTS AND TECHNIQUE

Section 5.3 of this guide is dedicated to the discussion of work paper development, contents and technique.

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AUDIT GUIDE
ORGANIZATION OF AUDIT FILES
REDUCED SAMPLE OF CURRENT AUDIT FILE INDEX

CURRENT FILE INDEX

AUDITEE:	AUDIT DATE: / /
AUDITOR IN-CHARGE:	AUDIT TYPE:

INCLUDED	INDEX #	DESCRIPTION
	1	Audit Work Order
	2	Audit Program
	3	Reportable Conditions Point Sheets
	4	Audit Report
	5	Written Repsonse of Official
	10	Notes for Subsequent Audits
	20	Reports Generated by Auditee
	30	General Ledger Analysis
	40	Bank Reconciliations & Analysis
	50	Cash Counts
	60	Receipt Tests
	70	Disbursements Tests
	80	Confirmations
	90	Open Section
	100	Fixed Assets
	110	Payroll Handout

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
ORGANIZATION OF AUDIT FILES
REDUCED SAMPLE OF AUDIT WORK ORDER

AUDIT WORKORDER

AUDITEE:	AUDIT DATE: / /
AUDITOR IN-CHARGE	AUDIT TYPE:

COMMENTS:

AUDIT STEPS	TOTAL HOURS	DATE										

AUDIT REVIEW AND SIGNOFF				
STEPS	AUDITOR IN-CHARGE		SUPERVISOR	
	INITIALS	DATE	INITIALS	DATE
Preliminary draft of report written & ready for review with official				
Final audit report ready to be issued				
Audit is complete and ready for filing				

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
STEPS IN AN AUDIT
INTRODUCTION

Auditing is an "art" and a "science." The "art" part is a "sixth sense" auditors acquire. "Sixth sense" makes auditors question things productively. Questioning is not condemning, accusing or condescending. The auditor develops "sixth sense" by practicing healthy skepticism. The most dangerous auditor tendencies are as follows:

- Tendency to accept things at face value merely on appearances,
- Tendency to believe everything they hear without independent verification,
- Tendency to make assumptions without having all the facts and
- Lack of curiosity and/or aggressiveness.

Healthy skepticism means an auditor questions everything and **never "assumes" anything**. If an explanation does not sound right, it probably is not. Before jumping to conclusions, an auditor must gather facts. An auditor must ask many questions and make observations. Auditors must carefully phrase questions so as not to offend the auditee, lead the auditee to "correct answers" or intimidate the auditee.

The following "danger signs" suggest problems within an auditee's department:

- Auditee is unable to answer questions about subjects with which they should be familiar.
- Auditee is in personal financial trouble or is living beyond their means.
- Auditee's records are sloppy. Sloppy records can indicate poor attitude, poor internal controls or fraud cover up.
- Auditee is agitated by auditor questions.
- Auditee "cannot find" documentation requested by auditor.
- Auditee takes short or no vacations. Individuals who handle cash and are involved in fraud cannot afford to take time off and risk the discovery of their scheme.

It is critical for an auditor to learn the art of accumulating and assessing facts. An auditor must form conclusions based on these facts. Does each piece of the puzzle fit? Does everything pass the "stink test?"

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INTRODUCTION

Where does the "art" side of auditing come from? How does one improve the "art" side of auditing? The "art" of auditing comes from one's basic personality and character with improvement coming from the "science" component of auditing.

The "science" part of auditing includes time proven procedures and techniques that lead the auditor to valid and productive conclusions. Procedures and techniques form the basis for the remainder of this chapter - Steps in an Audit.

The "science" part of an audit is broken down into steps. The auditing "art" is used with professional judgment in deciding auditing steps. Steps and their order are outlined as follows:

A. DETERMINE AUDIT OBJECTIVES

B. PRELIMINARY REVIEW

1. Understand office
2. Review prior audits
3. Interview office holder

C. FIELD WORK

1. Review internal controls
2. Develop audit program
3. Perform audit program steps
4. Identify and evaluate findings
5. Perform additional audit procedures, if necessary

D. COMMUNICATING AUDIT RESULTS

1. Review Reportable Conditions Pointsheets
2. Write preliminary audit report
3. Hold an exit conference and present preliminary audit report
4. Issue audit report with county auditor's signature

E. CLOSURE

1. File cleanup
2. Final review
3. Filing work papers

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
STEPS IN AN AUDIT
DETERMINE THE OBJECTIVES OF THE AUDIT

General audit objectives are noted in subchapter 2.2 of this guide. When starting a specific audit, objectives are taken a step further.

Before an auditor proceeds, it is necessary to identify specific audit objectives. Audits are compliance, substantive or fraud. Most audits conducted by the county auditor's office have some elements of each audit type. Compliance audits test compliance with policies and procedures. Substantive audits verify balances (i.e., a bank reconciliation). Fraud audits detect the existence and extent of fraud.

Audits are divided into five basic categories for audit calendar and audit program purposes:

- **Audits of officials**

  - **Limited scope audits** are done with greater frequency, usually monthly. Only limited substantive audit procedures are done. Unless significant audit points are detected, no audit report is issued.

  - **Full scope audits** are performed quarterly, semiannually, or annually, depending upon the particular auditee. Audit procedures include compliance and substantive testing. An audit report is issued.

  - **Full scope surprise audits** are required annually. The auditor randomly selects the date of the surprise audit. The auditee is unaware of the audit date.

- **Fixed asset/inventory observations** are primarily substantive in nature and are accomplished through specialized audit programs. Most audit steps discussed in the remainder of this chapter do not apply to these audits.

- **Analysis of general ledger accounts** is primarily substantive in nature and is accomplished through specialized audit programs. Most audit steps discussed in the remainder of this chapter do not apply to these audits.

- **Payroll handouts** are primarily substantive in nature and are accomplished through specialized audit programs. Most audit steps discussed in the remainder of this chapter do not apply to these audits.

- **Special request audits** include, but are not limited to, fraud audits and are coordinated by the Audit Manager under specialized audit programs. Audit reports of some form are normally issued.

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AUDIT GUIDE
STEPS IN AN AUDIT
PRELIMINARY REVIEW

The preliminary review objective is to obtain an understanding of the office/function. The preliminary review consists of understanding the office, reviewing prior audits, and interviewing the office holder.

UNDERSTAND THE OFFICE

To complete a competent and effective audit, it is imperative the auditor understands all facets of the auditee's office. A mechanic who does not have a working knowledge of every engine part has no business diagnosing it. The process is the same with a professional auditor. An auditor cannot complete a professional audit of an office without full knowledge of the office, laws governing the office and the environment under which it functions. An auditor must know the office's functions and function limitations. Auditors must address areas such as, but not limited to, the following:

- Determine office statutory duties,
- Review office holder's statutory authority,
- Determine nonstatutory duties performed in the office and
- Identify preliminary areas of risk.

Determine the statutory responsibilities of the office

To determine an auditee's statutory duties, statutory fees and statutory limitations, the auditor must be familiar with the laws governing the auditee. The primary sources for this information are as follows:

- Vernon's Local Government Code.
- "Guide to Texas Laws for County Officials" (Texas Department of Community Affairs).
- Public records such as minutes of the commissioners court meetings.

Review the statutory authority of the officeholder

Knowledge of the officeholder's authority is just as important as knowledge of the office holder's duties. The question becomes "Is the office holder doing something he shouldn't?" Sources mentioned in "deciding the statutory responsibilities of the office" also apply.

Determine nonstatutory functions performed in the office

If a duty performed by an official is not required by state statutes, the county auditor's office must still include the duty within the audit scope. For example, the sale of fire ant poison by the commissioners is not a required duty. Cash handling opens the possibility for misappropriation of funds and inventories. Additionally, the sales pose potential problems with sales tax. The auditor's office must audit "extra" functions.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
STEPS IN AN AUDIT
PRELIMINARY REVIEW

Identify preliminary areas at risk

Risk areas include cash collection, cash refunds, and disbursements. Other risk areas involve events that may put the County in a liability or asset loss situation.

REVIEW PRIOR AUDITS

Be familiar with County's independent auditor's management letter

With each annual audit by the County's independent certified public accountants, the County receives a "management letter" which points out internal control weaknesses and makes improvement suggestions. Each auditor in the county auditor's office should have a copy of the letter and be familiar with it. With county auditor's approval, each auditor follows through with implementing recommended changes effecting his assigned auditees.

Review prior audit work papers and audit reports issued by county auditor concerning the auditee

The auditor is responsible for clearing prior audit findings. The auditor determines if recommendations were made and followed. Auditee action since the prior audit help establishes the auditor's current audit plan. It is critical to review the reportable conditions point sheets and the audit report. Since some reportable conditions are expressed verbally, the audit report does not always contain all reportable conditions.

INTERVIEW THE OFFICE HOLDER

It is important to set a time with the official to conduct an entrance conference. It is important to know who is authorized to answer questions and retrieve documentation for the auditor. Without this knowledge, the auditor runs the risk of embarrassing the officeholder and his staff, as well as himself. If the auditor has done the audit before, he should know most of the entrance interview information. The auditor should interview the official to find out changes in staffing or procedures since the last audit. The interview is also a good public relations tool to learn "how's the family."

Establish the "ground rules"

It is important to get off to a good start with an auditee by setting some ground rules. This establishment should help reduce any misunderstandings. The auditor should ask:

- Who is authorized to answer the auditor's questions?
- Is there any staff assistance available to the auditor for document retrieval?
- What are the observed office hours?
- What are the worst times to do an audit? An auditor should avoid beginning an audit at times when the auditee's office is historically in a "time crunch." For example, auditing the automobile department of the tax office on the last day of the month would not be a good idea. Everyone waits until the last minute to buy their auto registration stickers, and the office is very busy.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
STEPS IN AN AUDIT
PRELIMINARY REVIEW

- If the auditor needs to work in the auditee's office, where does the office holder want the auditor to establish a work station?

Are there any particular areas of concern to the office holder?

An auditor should always give an official the opportunity to share his or her concerns about office problems. If there are some concerns, it can make the auditor's job easier, and it helps build goodwill with the official. If the official brings out concerns, the auditor should consider the following:

- The auditor weighs the concerns within the general objectives of the audit. It is important the auditor does not spend much time on tangents or do the official's job for him. Unless the Audit Manager and county auditor approve the additional work, the auditor should not spend much time on the problem areas. However, it may be possible to "guide" the official without spending valuable audit time.

- If the official's concerns are appropriate to include in the audit, the auditor adjusts his audit program to adapt to additional procedures required.

- If the auditor postpones investigating the official's concerns, the auditor makes notes of future plans in the work papers and informs the official of the plans. **An auditor must never leave an official feeling that his concerns have been ignored or forgotten.**

Clearly express the auditor's expectations

The auditor tells what is expected and needed during the audit. Examples of areas for the auditor to cover are:

- The auditor communicates documentation needs. If a staff member is reluctant to release documentation to an auditor, the auditor politely backs away from the staff member. The auditor asks the official to make the staff member comfortable with releasing information and documentation to the auditor. Remember, the staff member is usually just trying to protect his job and is doing what he thinks his boss wants. Do not provoke staff members with "Well, I am from the county auditor's office and I have access to everything!" Authoritative attitudes alienate the auditees from the auditor.

- The auditor communicates how much time the audit should take.

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AUDIT GUIDE
STEPS IN AN AUDIT
PRELIMINARY REVIEW

Identify what the office holder can expect from the audit

All audits include at least an exit interview, and many audits require a written report. It is important the official knows what the auditor does because of the audit. At a minimum, the auditor should advise the office holder concerning the following:

- An exit interview should occur.
- If any recommendations or audit points are in audit report draft, the auditor discusses the items with the office holder.
- The auditor indicates what kind of report should be written.
- The auditor asks who should receive final copies of the audit reports and when.

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AUDIT GUIDE
STEPS IN AN AUDIT
FIELD WORK

Field work describes work auditors do at the auditee's premises. The auditor completes as much audit work as possible in the auditee's office. A significant part of any routine audit is the auditor's physical observance of the routines, procedures and attitudes in the auditee's office. When the auditor has obtained the necessary audit evidence, the field work is complete. The auditor is ready to write the report.

Field work follows a logical progression the whole way ensuring all required audit work is done and unnecessary audit work is avoided. Field work progresses through the following steps:

- Document and evaluate (or review in a repeat audit) the auditee's internal control systems,
- Prepare (or reevaluate in a repeat audit) the audit program,
- Evaluate the use of sampling and
- Perform the audit.

DOCUMENT AND EVALUATE (OR REVIEW) THE AUDITEE'S INTERNAL CONTROL SYSTEMS

The documentation and evaluation of the auditee's internal control system is extremely important. An entire chapter of this guide is provided to guide the auditors in documenting and evaluating an auditee's internal controls. When reaching the internal control system documentation and evaluation portion of an audit, guide users are directed to Chapter 4.

On a full scope audit, an auditor always **critically reviews** the existing documentation and evaluation of the auditee's internal control systems. The auditor makes appropriate modifications to the permanent file reflecting changes in the organization chart, procedures, forms, reports, laws, etc.

PREPARE (OR REEVALUATE) THE AUDIT PROGRAM

Although there are many similarities in audit programs, the auditee audit program is customized to match the individual auditee characteristics. For example, all justices of the peace do not always have identical procedures or internal control environments. Therefore, one audit program cannot necessarily serve each justice of the peace.

Before writing the audit program (or reevaluating it in a repeat audit), the auditor considers the following:

Recent significant changes

The auditor considers the impact of recent significant changes in elected officials, sources of revenues or cash receipts, types of cash disbursements, personnel policies or procedures.

Special concerns cited by the official or any other source

The auditor considers any special concerns cited by the official or any other source and expands his auditing procedures as necessary.

Specific audit objectives

Next, the auditor considers the specific audit objectives. The following list represents routine audit objectives that require revision depending on the audit:

- All monies or other assets to which the county is legally entitled -
  - Is properly collected.
  - Is in possession of the proper official.
  - Is proper in terms of the amounts charged.
  - Is proper in terms of the amounts received.
  - Is properly recorded.
  - Is properly reported.
- All monies collected are properly disposed -
  - By remittance timely to the proper entity.
  - Through proper cash management techniques.
  - In timely, authorized expenditures.
  - Through proper accounting and reporting.
- Operations conform to prescribed policies and procedures for -
  - What transactions are authorized.
  - When transactions are completed.
  - How transactions are completed.
  - Who is to perform the transactions.
  - Who is to authorize the various transactions.
- Operations are conducted in the most efficient and effective manner possible -
  - Deposits are made timely following the rapid deposit law.
  - Errors are quickly identified and kept to a minimum.
  - Authorizations occur only at the point required.
- Operations conform to other special factors such as -
  - Compliance with grants.
  - Specialized accounting principles.

Analytical review

The auditor gathers data to complete an analytical review of the auditee's statistics to decide whether the current information is **consistent** with the auditor's **expectations** in the circumstances. If they are not consistent, the auditor is alerted to a potential problem area. If the data is in line with expectations, the auditor may employ standard auditing techniques and move on to concentrate on more pressing areas. Analytical reviews, which are extremely important, are discussed completely at subchapter 5.4-6-1.

Consider preliminary materiality levels

The auditor considers the following factors in deciding materiality levels:

- The total funds handled in each office.
- The amount of cash, as a percentage of total monies, handled in each office.
- The degree of risk existing in each office. If relative risk is high, materiality levels are low. If relative risk is low, materiality levels are high.

"Level of materiality" assigned to each attribute, office, fund, or account is a matter of "professional judgment." As an audit progresses, it is necessary to establish preliminary levels of materiality for several reasons:

- To utilize the auditor's time most effectively and efficiently.
- To determine the nature, timing and extent of audit procedures.

The auditor is concerned with establishing pertinent materiality levels for each of the following:

- Individual account balances (salaries, office supplies, due to other funds).
- Each class of transactions (property tax receipts, cash disbursements, etc.)
- Each account group (general fixed assets, agency accounts, etc.)

Evaluate the use of sampling

Sampling is an audit technique to optimize the allocation of resources (auditors and audit time available) and keep audit risk to a reasonable level. Sampling has two purposes:

- Allows the auditor to examine less than 100% of the items in a population.
- Allows the auditor to draw a conclusion about certain characteristics of the total population based on the sampling results.

Guide users are directed to subchapter 5.4-7 for a sampling discussion.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
STEPS IN AN AUDIT
FIELD WORK

Design tests of compliance

Compliance tests provide the auditor with **reasonable assurance** the internal controls are **in place** and **operating as designed**. If the internal controls are in place and operating as designed, the auditor might conclude with reasonable assurance such things as:

- Receipts are properly completed and handled.
- Transactions are properly recorded.
- Calculations are correct.
- The auditee meets applicable laws and regulations.
- Errors are discovered through the **normal** course of business and on a **timely** basis. In other words, the system does not rely on the auditor to detect errors. The system of checks and balances handles error detection.

If the compliance tests provide reasonable assurance, the auditor progresses to substantive testing or another audit phase. If the auditor is not assured the accounting controls are in place and operating as planned, he adjusts the audit procedures to the extent reliance may be obtained. If reliance is unattainable, the auditor resorts to examining every transaction in detail.

Risk is the fundamental idea to determining "reasonable assurance." Auditors are concerned with the following three areas of risk and their potentially material effect:

- The risk of noncompliance with an accounting control.
- The risk of noncompliance with laws and regulations.
- The risk the existing internal controls might not detect errors or prevent noncompliance.

Compliance tests are concerned with **error rates** and **rates of noncompliance** rather than dollar values. Evidence of ineffective internal controls include the following:

- Many clerical errors.
- Widespread carelessness.
- Frequent violations of accepted accounting principles.
- Frequent violations of applicable laws and regulations.
- Possible evidence of manipulation or fraud

Substantive tests

For each stated objective, the auditor conducts substantive tests and concludes if:

- Account balances are valid and proper.
- Transactions are valid and proper.
- Receipts and disbursements in the accounts are valid and properly classified.

Reach conclusions

With the audit objectives firmly stated and defined, the auditor pursues the accumulated evidence to sound conclusions. Subchapter 5.3-8 fully discusses conclusions. Briefly, the auditor should

- Keep conclusions simple and to the point.
- Logically organize the evidence.
- Present the basis for the conclusion.

PERFORM ADDITIONAL AUDIT PROCEDURES IF NECESSARY

After evaluating compliance and substantive tests results, some audits require expanded audit procedures. For example, the auditor selects a sample and relies on internal controls. After testing the sample, the auditor finds out the internal control system is not operating as documented. The auditor might expand the sample size or apply alternate audit procedures. As another example, many dismissals are noted. The auditor considers sending independent confirmations to the persons whose cases were dismissed to find out they were dismissed.

OTHER COMMENTS

New audits to the county auditor's office

Substantial time is required for offices or functions without prior audits. Since the objectives are new, no permanent file exists to understand the office and the related internal controls. Each new audit is a learning experience for the auditor and the auditee. Time spent with the new auditee builds a solid foundation for future audits. Suggested improvements and exceptions require positive communication.

New audits to the field auditor

Audits done by other county auditor personnel in the past may be assigned to another auditor through a rotation program. The audit requires more time by the new auditor. In these instances, a permanent file exists and also past audit files and audit reports. The new auditor becomes thoroughly familiar with the permanent file, the statutory requirements of the auditee, the systems documentation, organization charts and previous audit reports.

Design substantive tests

Substantive tests determine transactions are **accurate** and account balances are **reasonable**. They are concerned with **dollar values** rather than error or noncompliance rates. Accuracy and reasonableness are decided through detailed account analysis or on a sample basis.

Substantive tests include, but are not limited to, the following:

- Physical verification of an item for quantity and quality (cash counts, inventory observations, examining fixed assets, etc.).
- Tracing transactions through accounting records.
- Vouching account components back to supporting documentation.
- Negative and positive confirmations.

Set the timing for various stages of the audit

The audit schedule includes a time schedule and budget for the following matters:

- Audit start and conclusion dates.
- Surprise cash counts dates (do not tell **anyone**).
- Inventories and fixed assets observation dates.
- Confirmation mailing dates.

COMPLETE THE STEPS IN THE AUDIT PROGRAM

This phase of an audit is **not its starting point**. There is a tendency among some auditors, even in CPA firms, to jump into the audit program and start turning out work papers. Unfortunately, they are taking substantial risks and are leaving out critical parts of a complete audit. Instead, this audit phase is the time to build on all evidence collected and focus on areas of concern.

Tests of compliance

For each of the auditor's stated objectives, he conducts compliance tests and concludes if:

- Internal controls are operating as planned.
- Controls are effective in preventing or detecting errors or misstatements.
- He can continue the audit or part of the audit as planned.

Repeat audits

When an auditor is assigned to the same auditee through several audits, the audit inception requires less time. The auditor progresses rapidly into doing audit procedures on the audit program. A review of the recent audit reports and permanent file, along with other auditing steps described in this chapter is necessary. On a repeat audit, it is important to remain alert for organizational structure changes, internal control system deterioration, statutory changes, or reporting requirements changes. Since many offices change constantly, auditors should avoid complacency.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
WORK PAPER CONTENTS AND TECHNIQUE
AUDITS ARE PUBLIC RECORD

Article 6252-17a(Sec. 4) of *Vernon's Civil Statutes* states the following:

> "On application for public information to the officer for public records in a governmental body by any person, the officer for public records shall promptly produce such information for inspection or duplication, or both, in the offices of the governmental body. If the information is in active use or in storage and, therefore, not available at the time a person asks to examine it, the officer for public records shall certify this fact in writing to the applicant and set a date and hour within a reasonable time when the record should be available for the exercise of the right given by this Act [Open Records Act]. Nothing in this Act shall authorize any person to remove original copies of public records from the offices of any governmental body."

Because of this law, all audit reports and audit work papers are open public records, except in situations that are statutorily exempt, as follows:

- Pending litigation
- Unresolved criminal matters
- Records involving juveniles
- Records turned over to a law enforcement agency
- Uncompleted audits

The exceptions listed are encountered in few audits done by the county auditor's office.

For this primary reason, the auditors in the county auditors office must use good judgment in preparing work papers. Audit work papers of public accounting firms are the property of the firm and are only obtained by subpoena. However, work papers of the county auditor's office are much more accessible. **Assumptions, unsubstantiated judgments, and careless comments about personalities do not have a place in the work papers. Only facts belong in the work papers.**

Audit work paper should not contain **unresolved audit issues or unanswered questions**.

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WORK PAPER CONTENTS AND TECHNIQUE
EVIDENTIAL MATTER

Sufficient competent evidential matter is obtained through inspection, observation, inquires and confirmations. Evidential matter includes legible work papers cross-referenced to the written audit program. The work papers are properly indexed and contain objective, scope, methodology and audit results. Evidence is restricted to materially important matters and is relevant to the audit objectives. It is important the evidential matter show supervisory reviews of the audit work. Auditors use evidential matter to form a conclusion about the auditee's records. Since the evidential matter is the supporting data behind the audit conclusions, it is an integral part of the audit work papers and requires no oral explanation.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
WORK PAPER CONTENTS AND TECHNIQUE
STANDARD SIZE PAPER AND STANDARD BINDING

STANDARD SIZE PAPER

Standard size paper (8 1/2" x 11" or 8 1/2" x 14") is very desirable in the current and permanent audit files. Nonstandard size work papers should be attached to standard size paper. The auditor's office should maintain a good commercial brand of blank work paper. It is desirable to use the same brand for all work papers (7 column, 14 column, memorandum style, etc.). Photocopies of schedules, documents, reports, etc. are photocopied on standard size paper. Odd size documents such as confirmation replies, checks, receipts, etc., should be mounted on standard size paper. Auditors should remember to allow enough blank space for binding.

STANDARD BINDING

Standard size loose leaf binders are recommended for temporarily binding work papers during the field work and through the review process. After review notes are cleared, the work papers can be bound at the top or left with manila covers at the front and back. "Acco" type binders work well for this purpose. Until the binder is full, several months of current audit work papers can be placed in the same manila binder.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
WORK PAPER CONTENTS AND TECHNIQUE
INDEXING

Indexing is work paper numbering in an organized and consistent manner. It provides continuity throughout the audit files. If a reader wants to look at a bank reconciliation, he finds the current auditee file and section 41 of the work papers. Good indexing is a strong indication of professionally prepared work papers.

All indexing is placed on the bottom right of the work paper in red pencil.

Consecutive page numbers in a file are a form of indexing but are not functional in "living" sets of papers. If consecutive page numbers were used, page numbers continuously change. The audit guide is divided and indexed by section. For example, the audit guide is always section 5. When a citation is made of a particular Vernons Civil Statute, it is not cited as a page number but as Section X.y (z). The indexing used in our audit guide and in the statutes is the type the county auditor's office uses in its work papers. It allows expansion of pages without requiring the renumbering of succeeding pages.

The **Permanent File Index and Current File Index** provide the skeleton index to build work paper index numbers.

The auditor should review the indexing in this audit guide and understand the methodology. If this indexing method is unclear, the auditor should visit with the Audit Manager.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
WORK PAPER CONTENTS AND TECHNIQUE
CROSS REFERENCING

Cross referencing between work papers

Cross referencing ties numbers between different work papers. Cross referencing is done in red pencil only. A cross referencing example is shown on 5.4-3-2 to 5.4-3-4 of this audit guide. Please turn to the examples and mark the spot for the following discussion.

Some red numbers are circled and others are underlined. Some numbers are at the top left of referenced numbers and some are at the bottom right. There is a logical flow of information in work papers. Numbers from supporting work papers with "flowing" amounts **"flow to"** the primary work papers. Circled cross references placed at the bottom right of a number show the amount is **"flowing to"** the referenced work paper. The underlined cross references at the top left of a number indicate the amount is **"flowing from"** the referenced work paper.

On page 5.3-2-2, the cross references 5.4-3-3 and 5.4-3-4 are followed by a long red line. The red line is simply a ditto mark tied to the cross reference. Numbers immediately below the line are also from 5.4-3-3 and 5.4-3-4. This ditto mark red line is also seen on page 5.4-3-3 below the cross reference to 5.4-3-2. It indicates the $12,909.00, $45,309.00, $42,738.41 and $15,479.59 flow to page 5.4-3-2.

Cross referencing between work paper items

Cross referencing between amounts on a single work paper is shown on page 5.4-3-5. Two cross referencing methods are shown. One method uses arrows. The method is used sparingly and only when two numbers are close. Too many arrows on a work paper look sloppy. The other method uses circled alpha characters. Alpha characters are circled and placement is not significant. Alpha characters are used in same paper cross referencing, because numerical characters might indicate cross referencing to another work paper.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
WORK PAPER CONTENTS AND TECHNIQUE
TICKMARKS

Tickmarks are a shorthand explanation of a procedure completed. Standard tickmarks are reserved for certain procedures. Other procedures are evidenced by a tickmark of the auditor's choice.

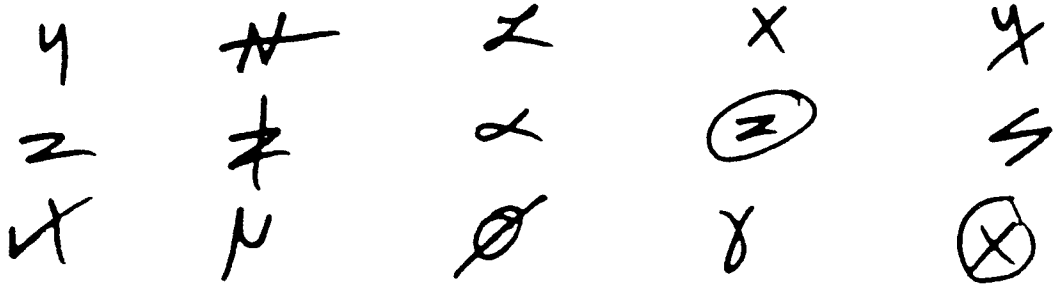
Standard tickmarks

Standard tickmarks are as follows:

7	Footed (recomputed the column to check the accuracy to the total and it was correct)
7c	Footed and Crossfooted (footed column and crossfooted the other column totals and the grand total was correct)
R	Recomputed (recomputed the multiplication or division and it was correct)
	NOTE: *Since "footing and recomputing" are verification procedures, auditors are not to use them on self-prepared work papers.*
✓	Procedure/attribute shown in column heading was satisfactorily done and no exception was noted
T	Traced to copy of receipt
A	Physically examined asset
N	Examined canceled check, noting date, payee and amount
C	Confirmation mailed
G	Confirmation received
GE	Confirmation received with exception

Custom tickmarks

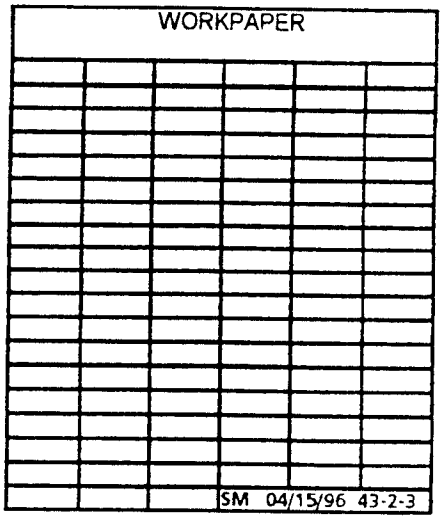
Custom tickmarks are created by the auditor for a procedure not designated above. Custom tickmarks are listed on the bottom of the work paper or shown on an attached work paper entitled "Tickmark Legend." The legend gives an explanation of the tickmark and must bear the initial of the auditor.



TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
WORK PAPER CONTENTS AND TECHNIQUE
INITIALING AND DATING WORK PAPERS

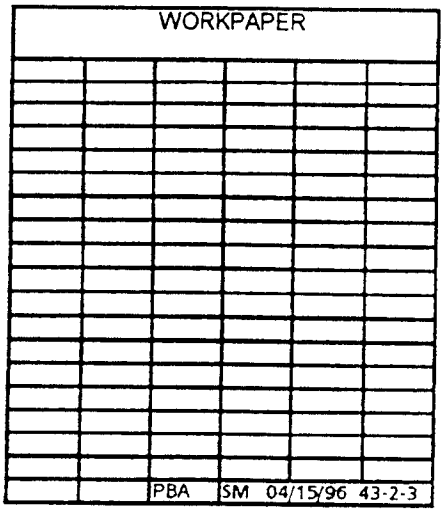
Work papers prepared by auditor

Each work paper prepared by the auditor requires initials and dates at the bottom right of the work paper. The initials and dates are immediately to the left of the index number.



Work papers prepared by the auditee

Originals or photocopies of documents prepared by the auditee bear the comment "PBA" in red pencil at the bottom of the work paper.



TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
WORK PAPER CONTENTS AND TECHNIQUE
AUDIT CONCLUSIONS

The audit conclusion is an audit summary and discusses the findings and recommendation. Conclusions are made from evidential matter documented in the work papers. Audit conclusions require indexing to the appropriate source work paper. Comments are not made in the conclusion without supporting work papers.

Remember, all audit reports and audit work papers are open public records. Assumptions, unsubstantiated judgments, and careless comments do not have a place in the work papers or audit conclusions.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
WORK PAPER CONTENTS AND TECHNIQUE
REPORTABLE CONDITIONS POINT SHEET

REPORTABLE CONDITIONS POINT SHEET

During the audit, the auditor records all audit findings and exceptions on reportable conditions point sheets. The reportable conditions point sheet is a form that an auditor records each finding, exception and/or reportable condition **as detected in the audit**. The auditor records both significant and insignificant points. If the auditor has an improvement idea for controls or procedures, he should record the idea on a reportable conditions point sheet. A reportable conditions point sheet example is presented at 5.3-9-2 of this guide. Comments are handwritten to encourage the recording of spontaneous comments.

If reportable conditions are not immediately recorded on reportable conditions point sheets, the auditor may forget them. If the reportable conditions prove insignificant or impractical, the conditions are discussed in the disposition section. The auditor uses the reportable conditions point sheet to formulate his comments for the exit interview and audit report.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
WORK PAPER CONTENTS AND TECHNIQUE
SAMPLE OF A REPORTABLE CONDITIONS POINT SHEET

REPORTABLE CONDITIONS POINT SHEET

OFFICE _____ DATE _____

AUDITOR _____

CONDITION _____

_____

_____

_____

_____

REASON IMPROVEMENT NEEDED _____

_____

_____

_____

_____

RECOMMENDATION _____

_____

_____

_____

_____

FOR COMPLETION BY FIRST ASSISTANT COUNTY AUDITOR:

1. RECOMMENDATION DISCUSSED WITH OFFICIAL? ___ NO ___ YES DATE _____

   IF NO, WHY NOT? _____

   _____

   _____

2. FINDINGS LETTER ISSUED TO OFFICER? ___ NO ___ YES DATE ISSUED _____

   IF NO, WHY NOT? _____

   _____

   _____

3. FINDINGS LETTER COPIED TO COMM COURT ___ NO ___ YES DATE ISSUED _____

OFFICIAL'S RESPONSE _____

_____

_____

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
AUDITING METHODS AND TECHNIQUES
GENERAL DISCUSSION

Auditors must use education, experience, and common sense to properly apply auditing methods and techniques during an audit. Auditing methods and techniques discussed in the upcoming section include observation, proofs of cash, cash counts, confirmations, analytical review, and sampling. Auditors must properly apply these methods and techniques to produce a successful audit with correct conclusions.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
AUDITING METHODS AND TECHNIQUES
OBSERVATION

During the audit, the auditor's observation of the auditee's office procedures is very important to developing a complete understanding of the auditee. Observation allows the auditor to verify the auditee practices the office procedures as documented in the internal controls. If the auditor observes practices in contrast to the office procedures, the auditor should revise the audit to discover why the office procedures are not followed.

Additionally, observation expands the auditor's knowledge of the auditee. Often, the auditee does not verbally tell all office practices or procedures to the auditor. The omission is usually the auditor's inability to ask the auditee "every possible question." Thus, the auditor's best auditing tool is his eyes and ears.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
AUDITING METHODS AND TECHNIQUES
PROOFS OF CASH

The traditional bank reconciliation is a "must" in any accounting system. Additionally, a proof of cash is essential as an auditing tool unless the following two criteria are met:

- Auditor obtains the bank statement unopened directly from the bank, AND
- Auditor opens the bank statement envelope and does the reconciliation, personally.

If an auditee's controls are inadequate or the auditee is a one-man office, auditee's bank accounts require a proof of cash (see form at 5.4-3-2).

A proof of cash reconciles the bank balances to book balances. Proofs of cash reconcile the transactions and reveals all monthly bank transactions. In comparing the proof of cash to the book transactions, the auditor locates unrecorded transactions. For example, a normal bank reconciliation would not detect the following scenario.

- A clerk orders a separate set of preprinted checks through the mail.
- When the checks arrive in month one, the clerk writes a check to himself (or a fictitious payee) for $5,000.00 and invests the money in a temporary investment.
- On the last day of month one, the clerk borrows $5,000.00 from a lending source and deposits the money into the auditee's checking account.
- When the bank statement is received for month one, the clerk removes and destroys the $5,000.00 check and the $5,000.00 deposit slip. The clerk reconciles the bank account.
- At the beginning of month two, the clerk writes a $6,000.00 check to himself (or a fictitious payee) and continues the growing cycle.

An example of a completed proof of cash and related documents is shown at 5.4-3-2.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
AUDITING METHODS AND TECHNIQUES
PROOFS OF CASH
PROOF OF CASH EXAMPLE

C:\INFORMS\FORMS\CSHPROOF.001

PROOF OF CASH

ACCOUNT NAME: General Departmental

AUDITEE: David Pareya, J.P. Pct 3	
AUDITOR: Bill Lawrence	AUDIT DATE: 5/31/95

DESCRIPTION	BEGINNING OF MONTH 4/30/95	ADDITIONS	REDUCTIONS	END OF MONTH 5/31/95
PER BANK STATEMENT 5.4-3-3	12,909.00	45,309.00	42,738.41	15,479.59
DEPOSITS IN TRANSIT, BEGINNING (1)	+ 1,845.00	- 1,845.00		
DEPOSITS IN TRANSIT, END (1)		+ 198.00		+ 198.00
OUTSTANDING CHECKS, BEG. (1)	- 8,761.00		- 8,761.00	
OUTSTANDING CHECKS, END (1)			+ 9,150.00	- 9,150.00
OTHER RECONCILING ITEMS				
Erroneous Bank				
Charge (A)			- .41	+ .41
PER BOOKS 5.4-3-4	5,993.00	43,662.00	43,127.00	6,528.00

COMMENTS:
(A) Kelly Larson to contact bank for correction
BL

(1) ATTACH DETAILED LIST

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
AUDITING METHODS AND TECHNIQUES
PROOFS OF CASH
PROOF OF CASH EXAMPLE - BANK STATEMENT

PAGE 1

REGULAR CHECKING ACCOUNT

ACCOUNT NUMBER
SSN/FED ID
STATEMENT AS OF 5/31/95
PREVIOUS STMT DATE 4/30/95
#OF DAYS-STMT PERIOD 31

**** STATEMENT PERIOD ****

PREVIOUS BALANCE	12,909.00
16 DEPOSITS/CREDITS	45,309.00
9 CHECKS/DEBITS	42,738.41
ENDING BALANCE	15,479.59
MINIMUM BALANCE	271.00
INTEREST PAID YTD	.00
AVG COLLECTED BALANCE	9,695.90
AVG LEDGER BALANCE	11,172.84

5.4-3-2

DEPOSITS

DATE	AMOUNT	DESCRIPTION
5/01/95	1,562.00	DEPOSIT
5/08/95	2,076.00	DEPOSIT
5/08/95	283.00	DEPOSIT
5/08/95	5,753.00	DEPOSIT
5/08/95	2,935.00	DEPOSIT
5/09/95	2,419.00	DEPOSIT
5/11/95	3,196.00	DEPOSIT
5/15/95	1,121.00	DEPOSIT
5/15/95	3,046.00	DEPOSIT
5/16/95	1,200.00	DEPOSIT
5/22/95	4,759.00	DEPOSIT
5/23/95	5,032.00	DEPOSIT
5/24/95	3,136.00	DEPOSIT
5/26/95	2,281.00	DEPOSIT
5/31/95	3,021.00	DEPOSIT
5/31/95	3,489.00	DEPOSIT

WITHDRAWALS /CHARGES

DATE	AMOUNT	DESCRIPTION
5/31/95	.41	OD INTEREST CHARGE

Bank error

CHECKS

DATE	AMOUNT	CHECK#	DATE	AMOUNT	CHECK#

CONTINUED

Member F.D.I.C.

Please examine at once: If no error is reported in 10 days the account will be considered correct and vouchers genuine.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
AUDITING METHODS AND TECHNIQUES
PROOFS OF CASH
PROOF OF CASH EXAMPLE - BANK TRANSACTIONS REPORT

BANK TRANSACTIONS REPORT - JUSTICE OF THE PEACE 3 - DEPARTMENTAL GENERAL ACCOUNT

For the Month Ending 5/31/95

By David W. Pareya - Justice of the Peace - Precinct 3 Dept. No. 14531

Form 14531-311 (2-91)

DEPARTMENTAL GENERAL ACCOUNT 07-2500-2 - Checks Nos. 2294 to 2304

Description	Account Code	Amount
1. Beginning Bank Balance (from Previous Report)		5,993.00
Add Cash Receipts as Follows:	** PDC 203 ** ** ADC 054 **	5.4-3-2
2. General Collections of Fines and Fees	611-220990-14531	43,662.00
3. NOW Interest Added by Bank to General Account	611-220990-14531	
4. Interest Paid by Bond Account to General Account	611-101580-14531	
5. Returned Checks Redeposited	611-101530-14531	
6. Other Collections (Specify)	611-220990-14531	
7. Total Receipts - Sum of Lines 2 thru 6		43,662.00
8. Available Resources - Sum of Lines 1 and 7		49,655.00 5.4-3-2
Less Disbursements as Follows:	** PDC 303 ** ** ADC 055 **	
9. Payments to County Treasurer	611-207699-14531	42,597.00
10. Payments to Officers of Other Counties	611-220921-14531	
11. Payments to Texas Railroad Commission	611-220922-14531	90.00
12. Payments to Texas Parks & Wildlife Department	611-220922-14531	
13. Payments to Municipalities	611-220923-14531	
14. Refunds to Plaintiffs	611-220928-14531	440.00
15. Checks Returned by Bank (Attach Check Copies)	611-101530-14531	
16. Other Disbursements (Specify)	611-220929-14531	
17. Total Disbursements - Sum of Lines 9 thru 16		43,127.00 5.4-3-2
18. Ending Bank Balance - Line 8 less Line 17		6,528.00

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
AUDITING METHODS AND TECHNIQUES
ANALYTICAL REVIEW

Most field audit work is detailed in nature. Analytical review is a valuable tool giving the auditor a chance to examine the "big picture". The auditor uses analytical review to determine the **consistency** of information with the auditor's **expectations**. Some auditors call it the "stink test" approach. If results are not consistent, the auditor is alerted to potential problem areas. If results are in line with expectations, the auditor has reasonable assurance no significant problems exist.

Analytical review types include but are not limited to the following:

- **Trend analysis** (or **fluctuation analysis**) compares data between two or more periods. The data is not limited to dollars. The data can include dollars, number of receipts processed, quantity of aviation fuel sold, gallons of fuel consumed, etc. The auditor compares data of one period (day to day, week to week, etc.) to the same type of data from one or more comparable prior periods. Generally, it is more effective to have several prior periods of data to compare to the current period. If the auditor detects any significant increases or decreases between periods, he should pursue the change to determine the reason for the fluctuations. **Conversely**, the auditor may **expect** a particular revenue to vary because of changes in the law, fee structure or season. If the analysis does not show the expected change, the auditors should investigate the reason.

- **Component analysis** examines component ratios. Cash collections to total collections and diesel fuel gallons consumed in relation to fuel gallons consumed, etc. are examples of component ratios. If an office's cash to check ratios change drastically in relationship to a previous period, a problem could exist. Relationships and mixes do not change without a cause.

- **Relational analysis** examines the relationship between corresponding data. If an auditor knows the beginning inventory, amount used, and ending inventory, the auditor can determine the inventory purchases. If the computed purchases differ from the purchases on the general ledger, the auditor should apply additional auditing procedures to determine the reason for the variance. If a material difference exists between projected sales and actual sales, the variance warrants additional audit procedures.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
AUDITING METHODS AND TECHNIQUES
CONFIRMATIONS
CONFIRMATION FORMAT FOR DISMISSALS IN JUSTICE COURT

LETTERHEAD

Date

Name
Firm
Address
City, State & Zip

Dear_____:

As part of our regular audit procedures, we periodically seek independent verification of ABC County records. Please review the information below. If it is correct, please sign part A. If it is not correct, please sign part B, and provide us with the information according to your records.

After signing, please return this form to Mr. Ken U. Catchem, Audit Manager, 215 North 5th Street - Suite 130, Anyplace, Texas 76701-1366. A postage-paid, self-addressed envelope has been enclosed for your convenience. If you have any questions, please contact me at (817) 757-5156.

Sincerely,

Ken U. Catchem

Your name appears on ABC County records as having receiving the following citation, and that it was dismissed, with no fine assessed.

Ticket number:_____
Date of violation:_____
Violation charged: _____
Justice of the Peace Court, Precinct _____
Located at: _____

A. The above information is correct. _____

B. The above information is not correct. _____

Comments: _____

_____

_____

_____

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
AUDITING METHODS AND TECHNIQUES
CONFIRMATIONS
CONFIRMATION FORMAT BASED ON LIST OF OPEN CITATIONS FROM DPS

LETTERHEAD

Date

Name
Firm
Address
City, State & Zip

Dear_____:

As part of our regular audit procedures, we periodically seek independent verification of ABC County records. Please review the information below. If it is correct, please sign part A. If it is not correct, please sign part B, and provide us with the information according to your records.

After signing, please return this form to Mr. Will Catchem, Audit Manager, 215 North 5th Street - Suite 130, Anyplace, Texas 76701-1366. A postage-paid, self-addressed envelope has been enclosed for your convenience. If you have any questions, please contact me at (817) 757-5156.

THIS IS NOT AN ATTEMPT TO COLLECT. IT IS FOR AUDIT PURPOSES ONLY. PLEASE DO NOT SEND MONEY TO THIS ADDRESS.

Sincerely,

Will I. Catchem

According to the records of ABC County, Texas, you received the following traffic ticket from the Texas Department of Public Safety on mm/dd/yy and have not paid a fine in relation to this ticket.

Ticket Number: _____
Violation: _____
Justice of the Peace Court, Precinct _____

A. The above information is correct. _____

B. The above information is not correct. _____

Comments: _____

_____

_____

_____

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
AUDITING METHODS AND TECHNIQUES
CONFIRMATIONS
EXAMPLE OF A CONFIRMATION FORMAT FOR COST DEPOSITS IN DISTRICT CLERK'S OFFICE

LETTERHEAD

Date

Name
Firm
Address
City, State & Zip

Dear_____:

As part of our regular audit procedures, we periodically seek independent verification of ABC County records. Please review the information below. If it is correct, please sign part A. If it is not correct, please sign part B, and provide us with the information according to your records.

After signing, please return this form to Mr. Will Catchem, Audit Manager, 215 North 5th Street - Suite 130, Anyplace, Texas 76701-1366. A postage-paid, self-addressed envelope has been enclosed for your convenience. If you have any questions, please contact me at (817) 757-5156.

Sincerely,

Will U. Catchem

The ABC County District Clerk has a cost deposit balance on hand for you in the amount of $_____ at May 31, 199X

A. The above information is correct. _____

B. The above information is not correct. _____

Comments: _____

_____

_____

_____

_____

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
AUDITING METHODS AND TECHNIQUES
CONFIRMATIONS
GENERAL DISCUSSION

Bank confirmations are categorized as negative or positive.

Negative Confirmations

Negative confirmations are usually sent by banks or credit unions with customer statements. An negative confirmation example is shown below:

MCLENNAN COUNTY EMPLOYEES
FEDERAL CREDIT UNION
215 N. 5TH ST., SUITE 224
WACO, TEXAS 76701
(817) 757-5015

NOTICE:
SEE REVERSE SIDE FOR IMPORTANT INFORMATION
REGARDING YOUR RIGHTS TO DISPUTE BILLING
ERRORS OR QUESTIONS ABOUT YOUR ELECTRONIC TRANSFERS.

ACCOUNT #: 20300
PAGE: 1
SOC SEC #: 449-96-8138

THIS IS THE SUPERVISORY COMMITTEE ANNUAL AUDIT--IF AN ERROR IS
FOUND PLEASE CONTACT LINDA VANDENBERG (757-5057) P.O. BOX 2451
WACO, TX 76703

[redacted]
WACO, TX 76705

STATEMENT PERIOD
MONTHLY FROM: 09/01/95
TO: 09/30/95
NON-MONTHLY FROM: 07/01/95
TO: 09/30/95

TRAN DATE	TRAN TYPE	TRANSACTION AMOUNT	RESULTING SHARE BALANCE	LOAN PRINCIPAL	*FINANCE* *CHARGE*	RESULTING LOAN BALANCE

Negative confirmations provide assurance as to the correctness of a large number of similar items (i.e. 14,562 bank balances). They are only effective if a large % of the population audited is mailed the confirmations. They require no action on the part of the addressee. Since they do not require a response, the auditor assumes no response is a good response.

Positive Confirmations

Positive confirmations request the addressee verify the audited balances. Positive confirmation examples are shown at 5.4-5-2 through 5.4-5-4.

Positive confirmations are used to confirm small populations. Positive confirmations are also used when the auditor believes the receiver may not pay attention to a negative confirmation. The auditor always makes photocopies of the confirmations before mailing them. The purpose of the copies is twofold. First, they serve as a source to make additional copies for second and third requests. If no reply is received, they provide evidence a confirmation was sent.

Generally, it is best to send stamped, self-addressed envelopes to encourage response.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
AUDITING METHODS AND TECHNIQUES
CASH COUNTS
EXAMPLE OF A COMPLETED CASH COUNT SHEET

CASH COUNT

AUDITEE: Lance Ito, Circus Master	
AUDITOR: Marcia Clark	COUNT DATE: 9/26/95
CASH CUSTODIAN Johnny Cochran	
DESCRIPTION OF CASH COUNTED: Johnny Cochran's cash drawer	

CASH AND CURRENCY

DENOMINATION	AMOUNT
.01	.16
.05	.30
.10	1.20
.25	4.25
.50	—
1.00	47.00
5.00	95.00
10.00	160 00
20.00	1,200.00
50.00	-
100.00	500.00
TOTAL	2,007.91

CASH FUND RECAP

CASH AND CURRENCY	2,007.91
CHECKS & MONEY ORDERS	(A) 9,200.00
TOTAL MONIES ON HAND	11,207.91
LESS CASH CHANGE FUND	500.00
MONIES COUNTED, EXCLUSIVE OF CHANGE FUND	10,707.91
TOTAL OF RECEIPTS ISSUED SINCE LAST DEPOSIT	(B) 10,706.93
CASH OVER (SHORT)	.98

THE ABOVE CASH WAS COUNTED IN MY PRESENCE, AND WAS RETURNED TO ME INTACT

BY Johnnie Cochran

RECEIPTS TO ACCOUNT FOR

BEGINNING RCPT. NO.	ENDING RCPT. NO.	BATCH TOTAL	MANUAL OR COMPUTER GENERATED
987651	987662	8,216.50	☐ MANUAL ☑ COMPUTER
1723	1726	2,490.30	☑ MANUAL ☐ COMPUTER
			☐ MANUAL ☐ COMPUTER
	TOTAL (B)	10,706.83	

CHECKS / MONEY ORDERS

SOURCE	AMOUNT	SOURCE	AMOUNT
Mark Fuhrman	2,000.00		
O.J. Simpson	500.00		
Juror #947	300.00		
F. Lee Bailey	2,500.00		
Robert Shapiro	3,900.00		
		TOTAL (A)	9,200.00

IF ADDITIONAL SPACE IS NEEDED, CONTINUE LISTING ON SEPARATE PAGE. JUST RUN ADDING MACHINE TAPE IF > 30 CHECKS

- A space is provided on the cash count sheet to list checks and money orders. If there are more than 30 checks, the auditor should run an adding machine tape of the checks instead listing the checks. Auditors permanently attach the tape to the cash count. **The auditor notes the following items on a Reportable Conditions Point Sheet and attaches photocopies of the items:**

  - There is a check from any employee of the County. Point sheets note the check date.

  - There is a check or money order dated prior to the last deposit date. Auditors should consider possible mail lag time.

  - There is a two party check.

  - There is a check which appears altered or unusual.

  Discretion is used in preparing the reportable conditions point sheets. Instead of recording details on the point sheet(s) in view of the cashier, it is best to make brief notes on a separate pad while doing the cash count. Immediately after leaving the auditee's office, the auditor should transfer the information to a point sheet .

- The auditor determines which receipts were issued after the last balancing process. List the receipt range(s) on the space provided on the cash count sheet. There is space for three receipt ranges and boxes to "check" indicating whether the receipts are computer generated or manual.

- The auditor completes the cash fund recap section of the cash count sheet. The auditor assists the cashier in determining the cause of any shortages or overages.

CLOSURE

- The auditor obtains the cashier's signature on the cash fund recap section of the cash count sheet.

- Discrepancies are noted on reportable conditions point sheets.

FOLLOW UP

When the bank statement arrives for the month of the cash count, the auditor traces the cash count deposit to the bank deposit. The auditor places a copy of the cleared deposit slip with the bank stamp and a copy of the bank statement page showing the deposit in the work papers behind the cash count sheet.

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CASH COUNTS

The auditor does an annual surprise cash count at each cash collection point. A surprise cash count is unannounced. An example of a cash count sheet is at 5.4-4-4 of this guide.

Cash count steps are as follows:

PLANNING

- The auditor decides the best day for the cash count. For example, a cash count on the first or last day of the month in the automobile department is bad timing. A December 31 cash count in the ad valorem tax office is insanity. Employees are anticipating their New Year's Eve party and taxpayers are paying their last tax deduction. Auditors should respect the auditee's specific situations and do the cash count at a reasonable time.

- At least six weeks before the surprise cash count, the auditor finds out the time of day the auditee counts and balances cash. This time is the best time to accomplish a surprise cash count.

- The auditor decides the number of auditors required to accomplish the count.

FIELDWORK

- The auditor enters the auditee's office a few minutes before the cashier closes and balances cash and advises the officeholder of the annual surprise cash count, as required by law. By informing the office holder of the law requirement, he is not alarmed by the "invasion." If the office holder is gone, the auditor should locate the in charge employee and continue with the cash count.

- Do not intimidate the employees. Usually, employees are intimidated by auditors. The auditor should discuss the cash count procedures in terms easily understood by the employee. In other words, do not talk "over their heads." If the cashier makes excuses and wants the cash count at another time, it is **more important than ever** complete the count. If the auditee is acting suspicious, the auditor should discreetly contact the Audit Manager or the county auditor to "help" with the cash count."

- The auditor counts the cash or watches the cashier count the cash. The auditor records the count on the cash count work paper as it occurs. Do **not** allow the cashier to leave the auditor alone with the money. If the cashier is required to leave the cash, the cashier should either lock up the cash until he returns or have another office employee view the count.

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PROOFS OF CASH
PROOF OF CASH EXAMPLE - STANDARD BANK RECONCILIATION

Reconcilement of Account with State National [redacted]

To 5-31 1995 D. Polk JP Pct 3 Open

Date of Check	ITEMS	AMOUNT	Date of Check	ITEMS	AMOUNT	No	AMOUNT	No	AMOUNT	No	AMOUNT
	Your balance to your credit	1547959		Your balance to our debit	652800					2061	1000
	Our balance to your credit			Your balance to our debit						2078	2.00
	DIT									7302	65.00
5-31	We debited your account	198.00		We credited your account						2303	904.00
	# 2104 75.00									2304	15.00
	2105 75.00			CO TRUSTS							971.00
	2106 48.00			Bal 4/30 598300							(A)
	198.00			Coll 5/95 43,897.00							
				Pd 5/95 (43,597.00)							
				Due 5/31 6,403.00 Pd 4/95							
				TX REG							
				Due 4/30 90.00							
				Coll 5/95 90.00							
				Pd 5/95 (90.00)							
				Due 5/31 90.00							
				REFUND							
				Due 4/30 .00							
				Coll 5/95 440.00							
				Pd 5/95 (440.00)							
				Due 5/31 .00							
	(You debited (not on our books))			OTHER (not on our books)							
				Due 4/30 .00							
				Coll 5/95 35.00							
				Pd 5/95 .00							
				Due 5/31 35.00							
				652800							
	Bank Error										
5-31	Ins. Debt for Overdrafts	91									
	(Note to bankers Omit for correction)										
					(A) 9150.00						
	TOTAL	1567800		TOTAL	1567800						

LIST OF OUTSTANDING CHECKS

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SAMPLING

INTRODUCTION

Time is a precious commodity. Sampling allows auditors to reach reasonable conclusions within a time budget. Unless there is a problem, the auditor should not examine every transaction. The auditor is "auditing" records and not producing records.

Sampling has two purposes:

- Examine the least amount of a population to obtain the greatest assurance about the population.

- Based on sampling results, draw a conclusion about certain characteristics of the population.

Sampling is used in compliance and substantive auditing. With sampling in compliance auditing, the auditor's objective is to select a sample which is representative of the population. If the sample has an error rate of 5% and is reliable, the auditor concludes 95% of the population is correct. With substantive auditing, the auditor's objective is to obtain sufficient evidence to conclude about the correctness of particular balances. The analysis of an expense account is an example of using sampling in substantive auditing. For example, the auditor selects purchases over $10,000 and every 20th purchase to substantiate 70% to 90% of the dollar value with examining only 5% to 10% of the population. As another example, confirmations sent to a sample of citizens with dismissed citations reasonably substantiates the total dismissals volume.

WHEN TO USE SAMPLING

Auditors use professional judgement when using sampling. An auditor would probably use a sample of 100% in cases such as the following:

- The auditor has reviewed the internal control system and has little or no confidence in the internal control structure.

- The audit staff has unlimited time.

- The auditee office has few transactions and selecting a sample is more time consuming than auditing all transactions (i.e. small one-person justice of the peace office).

- A 100% sample is required by the audit terms (i.e. certain grants).

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SAMPLING

Whether sampling is used or not, an auditor **always look at all unusual items**. The auditor should always look at the following items:

- Unusually large or small values,
- One of a kind transactions,
- Transactions involving personal business of the office staff or official,
- Known problem areas,
- Controversial areas,
- Areas currently in the public eye (high exposure) and
- Anything that seems unusual.

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SAMPLING

DEFINING A POPULATION

Before an auditor can select a sample, he defines the population. Basic parameters are defined first and can include the following:

- The auditor defines the test period. Test and audit period are usually the same. In a large audit, the auditor has the option of selecting a test period within the audit period. For example, an auditor might consider selecting a test month for a semi-annual or quarterly audit.

- The auditor defines the sampling unit . Sampling unit examples include cash receipts, checks, deposit slips, etc.

The auditor determines the completeness of the population. When auditing an office with computer generated and manual receipts, all receipts are included in the population. The same principle applies to checks.

After basic population parameters are defined, specific parameters are outlined.

- Transactions/documents dated within a given period of time. For example, checks issued beginning April 1 through June 30 or all receipts issued beginning October 1 through December 31 are defined in the population.

- Certain type of documents numbered "xxx" through "xxx". For example, receipt number "xxx" through "xxx" are included in the population and encompass the entire audit period.
- Assets in a particular location such as fixed assets in the District Clerk's office or inventory of culverts at Precinct 4.

DETERMINE SAMPLING METHOD

There are two basic types of sampling:

- **Judgmental sampling** allows auditors to determine size and composition of each audit without reference to other sources. Judgmental sampling is most appropriate with small to medium populations and good internal controls.

- **Statistical sampling** requires selecting the sample using mathematically defined levels of risk, precision and expected error rate. Auditors refer to statistical sampling tables for appropriate sample size and perhaps specific transactions for the sample. Statistical sampling is appropriate for a population with a large number of **homogeneous** transactions and a strong internal control system.

Judgmental sampling

Judgmental sampling is used in most audits performed by the county auditor's office. Judgmental sampling is divided into three broad categories:

- **Sequential sampling** selects every "nth" item from the population beginning at a defined starting position. For example, the auditor selects every 10th receipt beginning with receipt number 6541.

- **Random sampling** utilizes random number tables to select items from the population. Sequential sampling is considered "random" if the items in the population are in random order and the starting point is randomly selected.

- **Block sampling** selects a "block" of items from the population. A weakness in block sampling is it ignores personnel changes. However, it is very effective in detecting frauds such as lapping (fraud involving delays in the recording of cash receipts). The following items are examples of block sampling:

  - The population of receipts is numbers 1525 through 2416. The auditor selects a block sample from number 1845 to number 1945.

  - The population is checks issued for the quarter. The auditor selects the checks issued during a particular week for the block sample.

  - The population is all personnel. The auditor selects last names beginning with L, M, N, or O for the block sample.

Statistical Sampling

Statistical sampling allows an auditor to select a small sample from a relatively large homogeneous population. If sample results are satisfactory, the auditor reaches a legally and mathematically valid conclusion about the population. However, statistical sampling requires the use of cumbersome statistical tables in an excellent internal control environment. If statistical sampling is considered appropriate in an audit, the auditor should consult with the Audit Manager for guidance.

Stratified Sampling

Stratified sampling divides the population into subgroups or "strata" with each subgroup treated as a mini-population. The sample is selected from the subgroups. Different sampling methods are applied to each subgroup. Examples of stratified sampling are as follows:

When auditing a bank and counting vault cash, it is normal audit procedure to count using a **stratified sample**. Stratified sampling divides the risk into components. For example, risk of error is greater if one $100.00 bill is missing than if one $1.00 bill is missing

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SAMPLING

Currency in vaults is packaged in "straps" of fifty bills except for $50.00 bills and $100.00 bills which are in straps of twenty and ten bills, respectively. When counting vault cash, CPA firms usually open and count individually 10% of $1.00 bill straps, 20% of $5.00 and $10.00 bill straps, 50% of $20.00 bill straps and 100% of $50.00 and $100.00 bill straps. The advantage is verifying a high percentage of total dollar amount by counting a low percentage of the number of bills within the straps.

When analyzing a particular expense account, an auditor examines supporting invoices for items $25,000.00 or more and every 10th item under $25,000.00.

Stratified sampling is important because small and large items are selected. If an auditor only looks at large items, the auditee quickly learns the auditor's methods. After that point, carelessness or fraud in the handling of small transactions is potentially encouraged. There is also danger a small item may actually be an incorrectly recorded large item or a part of one.

AVOID BIAS

A tainted sample element results in a bias sample. Consequently, sample results are invalid and distorted. The following examples illustrate biased samples:

- A pollster steers poll results by controlling his sample of opinions. A poll determining the percent of the population smoking marijuana yields very different results depending on the sample source from which the opinion is collected (i.e. Stanford University, the First Baptist Church of Armadillo, TX, Willie's Fourth of July Picnic or random telephone calls). Bias is introduced by polling mall shoppers and surveying only persons between the ages of 18 yrs. to 35 yrs. or only persons over the age of 65 yrs.

- If an auditor uses block sampling for testing procedures compliance, the sample is potentially biased in the following situations:

  - An auditee hired employee A as the cashier from October through May, employee B for June, and employee C for July through September. If an auditor selects a block sample of June receipts, the sample is tainted because it only includes the work of one employee as cashier for 1/12 of the year. If the auditor selected two days from each month during the year or if Person A worked all year, the bias is eliminated.

  - An auditee routinely accumulates weekly mail receipts and deposits them on Friday with "walk-in" receipts. The cashier is lapping funds by taking some "walk-in" cash and replacing it with checks received in the mail from the prior week to cover the shortage. Mail receipts are prepared, but the originals are thrown away. If an auditor decides to perform a quarterly audit on Wednesday receipts, the sample is biased by excluding receipts related to the fraud activity and mail receipts. If the auditor elects to examine receipts of every 4th or 6th business day or a sequential sample of receipts, the bias is eliminated.

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SAMPLING

In each sampling procedure, the auditor carefully and objectively considers whether or not bias taints the sample. The following table shows the sampling methods, selection methods, and relative risk of bias.

SAMPLING METHOD	SELECTION METHOD	RISK OF BIAS
Statistical Sampling	Random	Theoretically non-existent
Judgmental Sampling	Random	Very low
Judgmental Sampling	Sequential (every "nth" item)	Moderate
Judgmental Sampling	Block	Highest when it is used in compliance testing. However, block sampling is the best way to determine prenumbered documents are all accounted for - by examining several blocks of documents.

SAMPLE SIZE

Random or Sequential Selection

Practically speaking, there is no relationship between sample size and population (except for very small populations). Sample sizes over 120 add little information or assurance involving populations under 500,000 items. On election day, the President of the U.S. is accurately predicted with an unbiased sample of only 2,000 people out of millions.

The county auditor's office should utilize random or sequential selection for compliance or verification type audits of homogeneous populations. The following audit procedures use random or sequential samples.

- Verification proper legally mandated fees are charged.
- Verification receipts are correctly recorded on a summary report.
- Verification of the existence of fixed assets.
- Verification of authorized signatures.
- Verification of mathematical accuracy on forms/reports.
- Inventory test counts.

Generally, sample sizes on random/sequential selected samples are as follows:

- Populations of 500 or less require a sample size of 25 items. If any discrepancies are noted within the sample, the auditor must increase the sample size to 60.
- Populations over 500 require a sample size of 60 items.

Block Selection

The block selection method is used primarily to determine sequential numbers are accounted for when auditing prenumbered documents such as receipts and checks (see the discussion of block sampling at 5.4-7-4). The auditor's office should use the following block sampling sizes:

- Populations of 500 or less require 3 batches of 10 sequential items starting from 3 different starting points.
- Populations over 500 require 4 batches of 15 sequential items starting from 4 different starting points.

SAMPLING PROCEDURE DOCUMENTATION

Sampling procedure documentation in audit work papers is important to validate audit work and to use as reference in future audits. The documentation includes a complete population definition, the sampling method, and selection method. The Audit Sample Selection Document presented at page 5.4-7-8 is a reduced copy of the required work paper which documents each sample relied on during each audit.

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SAMPLING
REDUCED COPY OF AUDIT SAMPLE SELECTION DOCUMENT

AUDIT SAMPLE SELECTION DOCUMENT

AUDITEE	

AUDITOR		AUDIT DATE	

OBJECTIVES

POPULATION

DESCRIPTION : _____

NUMBERED DOCUMENTS ? ☐ YES ☐ NO

IF YES, RANGE OF NUMBERS : FROM _____ TO _____

DATES COVERED : FROM _____ TO _____

IS POPULATION HOMOGENEOUS ? ☐ YES ☐ NO

IF NO, DESCRIBE RANGE OF DIVERSITY: _____

_____

SEQUENTIAL SELECTION

NUMBER OF ITEMS IN POPULATION: _____ SAMPLE SIZE: _____

STARTING POINTS: FIRST _____ SECOND _____ THIRD _____

Nth ITEM DETERMINATION:

Number of Starting Points X	Population Size /	Number of Starts	EQUALS	Nth ITEM INTERVAL

NOTE: If it becomes necessary to increase the sample size due to discrepancies in the first sample, continue using the same Nth item, but start from a fourth, fifth & sixth set of starting points until larger sample size is obtained.

INCREASE IN SAMPLE SIZE: _____
ADDITIONAL STARTING POINTS: FOURTH _____ FIFTH _____ SIXTH _____

BLOCK SELECTION

NUMBER OF IITEMS IN POPULATION: _____ NUMBER OF BLOCKS: _____

NUMBER OF STARTING POINTS: _____ NUMBER OF ITEMS PER BLOCK: _____

STARTING POINTS: FIRST _____ SECOND _____ THIRD _____ FOURTH _____

NOTE: If it becomes necessary to increase the sample size due to discrepancies in the first sample, and only three blocks were selected originally, select a fourth block, now.

STARTING POINT OF FOURTH BLOCK DUE TO DISCREPANCIES: _____

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
CONFIDENTIALITY OF INFORMATION GATHERED IN AUDITS

As discussed at subchapter 5.3-1, most audit work papers and reports are a matter of public record. Anyone has access to audit work papers and reports produced by the county auditor's office.However, audit work papers, audit reports and other audit field work information should be treated confidentially. Does the confidentiality concept conflict with the Open Records Act? No, not really. Since the Open Records Act gives everyone access to **records formally and specifically requested**, the inquirer must **actively seek out** certain records and spend time reading them. This avenue is the **only** way anyone has access to audit findings and conclusions. When we say audit knowledge should be confidential, we mean auditors should not **volunteer any** audit knowledge to anyone or **respond to questions** concerning audit knowledge from anyone except to those persons mentioned below, unless a formal Open Records Act request has been filed.:

- Other auditors in the county auditor's office (not payroll, accounts payable or support personnel -- just audit staff) who also follow the same confidentiality policy. It is important confidential information is shared between auditors (except in ongoing fraud investigations) so they learn about the questionable office and broaden their audit knowledge.

- The county auditor.

- The official audited or his designated supervisory personnel concerning the audit. Except as necessary for fact finding, the auditor should not discuss findings or opinions with other personnel in the auditee's office. If an auditee's employee asks about an audit, the auditor should refer them to their employer or the official of the office about which they are concerned.

- The other addressees of the audit report (i.e., commissioners court, district judges, etc.)

The confidentiality policy is critical to effective audits. It is critical to the audit staff a credible and trustworthy image is maintained. AN AUDITOR'S IMAGE AND CHARACTER IS PARAMOUNT! If anyone wants auditee information and pursues it through the Open Records Act, **they** have procured the information through due process. And, the auditor's trustworthiness is still intact, because the information was not offered.

REMEMBER! THE ACTIONS OF ONE AUDITOR REFLECT ON THE ENTIRE AUDIT STAFF! Auditors are professionals and should act accordingly. Gossip has no place in the audit. Each auditor is responsible for his image as well as the entire audit staff and should not let down the audit team by showing "friends" how much they are "in the know".

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
COMMUNICATING AUDIT RESULTS
GENERAL DISCUSSION

An audit is not complete until there has been an effective communication of the scope of the audit performed, the findings and the recommendations. This communication should be performed in several steps, as discussed below:

- Hold an exit conference and review the Reportable Conditions Point Sheets (see 5.3-9 of this guide).
- Draft the preliminary copy of the audit report using the point sheets.
- Deliver or mail the preliminary draft of the audit report.
- The final audit report can be issued.

A recent article was published by the Association of Government Accountants entitiled *Why Performance Audits Preceding Scandals Were Ignored.* While performance auditing is not a pressing issue for Texas county auditors at the writing of this guide, this article really relates to any audit report, It is well worth reading for anyone who is in the business of "communicating audit results." This article is reproduced at APPENDIX 10.8 with the permission of the Association of Government Accountants.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
COMMUNICATING AUDIT RESULTS
EXIT CONFERENCE

An exit conference is an opportunity for the auditor to "sell his product" to the auditee, build goodwill with the auditee and help ensure there will be **no surprises** for the auditee or the auditor. There is nothing more embarrassing to an auditor than presenting a final audit report making a recommendation to an auditee and having the auditee show the auditor a law or regulation prohibiting the carrying out of that recommendation. Auditees tell stories about those types of instances to all who will hear for years.

At the exit conference the auditee should have an outline of points to cover, if any, which are not included in the preliminary audit report, and should record the auditee's response to all points whether they are in the audit report or not. The exit conference should include the following:

- Discuss each point to the satisfaction of the auditee official.

- Obtain the official's agreement or disagreement for each point, and if he disagrees, the reason for disagreement. The auditor should not get hung-up defending his recommendations - it is alright for the auditor to agree to disagree with the official. It is important for the auditor to maintain a good and cordial relationship with the official - if the official is vehemently opposed to a recommendation, the auditor should simply state that he will discuss it again with his supervisors, and leave it at that. The county auditor or first assistant county auditor can then come in and be the "bad guys," if necessary, while the auditor maintains a good relationship with the auditee. Remember, the auditor's role at this point is primarily advisory. It is the responsibility of the official to make corrections and be in compliance with the law.

- Always comment on the current status of recent past audit points.

The audit exit conference must be documented in an audit exit conference memorandum. The audit exit memorandum should set forth the following points, at a minimum:

- Where the conference was held.

- The time and date of the conference.

- The names of those present at the conference.

- Issues presented by the auditor and the auditee's responses.

- Any other concerns brought forth by the auditee.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
COMMUNICATING AUDIT RESULTS
PRELIMINARY AUDIT REPORT

This part of the audit is dedicated to translating the auditor's field work into a rational, informative document. It is important that the report be written in such a way as to be unbiased, informative, to-the-point and **accurate**, and should contain the following key points:

- Key errors or discrepancies noted in the audit which are significant enough to be pointed out in the report. Remember, less significant points, and even more significant points which are "first offenses," can be discussed verbally in the exit interview with the officeholder, if deemed appropriate.

- Failures to follow either County's or the auditee's own office policies and procedures.

- Praise of the official if action was taken to correct deficiencies pointed out to the official in preceding audit reports.

- An offer that the county auditor's office is available to help the official in correcting any deficiencies pointed out in the audit report.

- Thanks to the official for his and his staff's assistance during the audit, unless this comment is totally unwarranted and out of color with the remainder of the report.

In citing deficiencies, the auditor should state all the related facts concerning the deficiency. If there are any violations of County or office policies and procedures or State laws, the specific policy, procedure or law should be referenced and cited. The auditor should then state a recommendation for improvement concerning the deficiency, keeping in mind the limitations of the auditee office (larger offices can do things the small offices cannot do).

If audit deficiencies continue in the audit reports of a particular official, the county auditor may have to take more drastic action than simply writing another report to that official. This could include addressing an audit to the Commissioners' Court or going to the District Attorney, although this last step will be very rare, and are to be done only by the county auditor, himself.

The preliminary draft should be prepared on plain paper (not letterhead) with words such as "Draft" or "Preliminary - for discussion only" written at the top of each page.

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AUDIT GUIDE
COMMUNICATING AUDIT RESULTS
ISSUANCE OF THE AUDIT REPORT

Auditees deserve a record of the auditor's review and findings in order to prove their performance record and the auditor needs it to help substantiate that the audit and communication occurred. Some statutes require that an audit report be issued annually, but the county auditor's office should, if practicable, go beyond that minimal requirement and issue reports more frequently.

The final audit report should be identical to the preliminary draft except for any changes to which the auditor and auditee agreed, it should be signed by the county auditor and should be on the county auditor's letterhead.

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AUDIT GUIDE
COMMUNICATING AUDIT RESULTS
STATUTORY REPORTING REQUIREMENTS

THIS SECTION WILL BE ADDED IN A FUTURE EDITION

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
FRAUD
RED FLAGS

Fraud was discussed briefly on page 5.2-1-1 of this guide and some "red flags" were listed. They are repeated here with some additional red flags to consider:

- The auditee is unable to answer questions about subjects with which they should be familiar.
- The auditee is in personal financial trouble, or conversely, is living beyond their apparent means.
- The auditee's records are sloppy. Sloppy records can indicate poor attitude, poor internal controls, or be a coverup for fraud.
- The auditee is agitated or edgy when questions are asked by the auditor.
- The auditee "cannot find" documentation requested by the auditor.
- The auditee takes very short or no vacations. Persons handling cash, and who are involved in fraud, cannot afford to take time off, because if someone else did their job, their scheme might be discovered.
- A new program is being phased in and the systems are not yet fully established.
- Employees of an auditee are very "tight" with information about procedures.
- There are significant delays in getting documentation or data from the auditee
- There are numerous adjustments to accounts, receipts, reconciliations, etc.
- Endorsements on canceled checks are odd or are endorsed by the auditee, as if they cashed it.
- Increases/decreases in volume of cash handled/revenues collected.
- Discrepancies noted between what an official thinks his office procedures are and what they are in reality.
- Someone in the auditee's office acts as if they are the only one qualified to handle transactions and/or refuses help from other employees.
- Things simply appear odd, but it is unclear as to why.

This is by no means an exhaustive list of red flags, but is presented as food for thought.

Anonymous/ Confidential Tips

Many frauds are discovered through tips from confidential or anonymous informants. The following is a list of things to remember or do when approached by such an informant.

- The auditor should assure them that their confidence will be protected, to the best of his ability, and then make absolutely certain that it is protected. Blown confidences will affect the credibility of the auditor and the entire audit team - and can totally close down the informal "information pipeline" for a long period of time. The informant is frequently taking a big chance by revealing information.

- The auditor should be sure the informant knows that if their tip results in a legal action by the County or District Attorney, they might have to give up their anonymity or could even be forced to testify either in person or by deposition.

- Listen to their comments and ask questions, but do always act in a professional noncommittal manner - try to keep them calm and unemotional.

- The auditor should encourage the informant to commit his comments to writing before the facts get "cold". The statement should address dates, times, occurrences names, etc. This will protect the auditor and may help preserve evidential matter. The informant should be asked to sign and date his statement.

- Remember their perceptions of the situation they are reporting may be totally wrong - or could be only the tip of the iceberg. The auditor should not take anything they say at face value until he has verified all the facts for himself.

- The auditor should ask the informant if he has discussed his concerns with anyone else; or whether or not he has heard anyone else discussing the supposed situation. If so, the auditor should advise the informant that it would be in his best interest, and in the best interest of the investigation, that he not reveal the meeting with the auditor to anyone - period.

- If the informant tells the auditor to talk to another party for additional information, the auditor should use careful judgement. The other party may have valuable and useful information, but, on the other hand, could be the alleged wrongdoer's Saturday night domino partner, and leak the existence of the investigation to the them.

- The auditor should treat all informants with respect and follow up with them, even if their information seems trivial - if they are snubbed they may never come forth when they have a serious issue. The auditor should follow up with them and make them feel like they are part of the investigation, if there is one, but information gained in the investigation should be shared with them only on a need to know basis.

The auditor should immediately contact the Audit Manager or the county auditor after contact has been initiated by an informant, and together they should decide what action needs to be taken.

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
FRAUD
WHAT IF SUSPECTED FRAUD IS DISCOVERED?

Suspected fraud discovered through routine audit procedures

When the auditor discovers a transaction or set of circumstances which leads him to believe that the existence of fraud is a possibility, some careful actions need to be taken, and professional decisions made. The following three key codependent objectives, and the actions necessary to accomplish each of them should be considered by the auditor:

PRESERVE EVIDENTIAL MATTER

If possible, the auditor should make photocopies of the documentation causing concern, or as a less desirable option, make notes sufficiently detailed for future reference. Care should be taken to gather this documentation using discretion so as not to cause undue interest of the auditee.

The auditor should also consider the possibility of destruction of records by the auditee if the auditor leaves the scene to meet with the county auditor or Audit Manager. In making this decision, the auditor should use professional judgement to try to determine whether or not the auditee is suspicious that the auditor has discovered something.

COMMUNICATE THE SITUATION TO THE COUNTY AUDITOR OR AUDIT MANAGER

As soon as possible after discovery, the auditor should contact the county auditor or Audit Manager to discuss the situation. It would be best if the auditor came back to the county auditor's Office to make this contact, unless:

- The auditor can use a phone in or near the auditee's office to make the contact with no risk of being overheard, or
- The auditor is concerned about the possible destruction of records, and needs to maintain his presence in the auditee's office, or
- The situation involves serious discrepancies noted in a cash count and requires the immediate presence of the county auditor or Audit Manager at the scene of the count. In these situations, **the auditor should not try to explain the situation over the phone** - he simply needs to state his location and that he needs assistance on an audit.

Contacting the county auditor, Audit Manager or District Attorney is vital to the auditor's personal safety and legal safety.

AVOID ANY OUTWARD INDICATIONS OF SUSPICION

The purpose of this objective should be self explanatory.

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If a suspected fraud is discovered, the county auditor and Audit Manager should determine the audit procedures which should be carried out. Each case will be different and the legal and liability factors will vary. In most situations, the Sheriff's Department and/or the Texas Rangers should be co-investigators, and most certainly the District Attorney's office should be co-investigators.

Some points the auditor needs to know on all fraud audits are as follows:

- Be alert for any new "red flags" - they may raise new issues
- The auditor should not accept explanations from the auditee at face value, until they have been verified by independent means.
- The auditor should be "low key" to avoid undue concern or curiosity from auditee's employees.
- The auditor should be extra cautious in protecting his workpapers and notepads to avoid having them read or destroyed by anyone. They should stay in his possession at all times - even when going to the restroom.

The auditor SHOULD NEVER discuss the case with anyone, except the following:

- The county auditor
- Audit Manager

and after the investigation begins,

- District Attorney's personnel directly assigned to the case
- Law enforcement personnel directly assigned to the case

The auditor should not answer questions from or make comments to:

- Auditee personnel
- Other county auditor's Office personnel
- Other County personnel
- Newspaper, radio, or television reporters
- Their family

Legal liabilities

Since auditors are not law enforcement officers, they are exposed to a different kind of liability when conducting fraud audits. It is called TORT LAW. Tort law is the law of personal injury, and there are several categories of personal injury to which fraud auditors are exposed, as follows:

- **Invasion of Privacy**
- **Intentional Infliction of Emotional Distress**
- **False Imprisonment**
- **Slander**
- **Libel**

Invasion of Privacy

The Supreme Court has held as recently as 1987 that where government employers are involved, there is a Constitutional right to privacy on the part of the employees.

Since the county auditor's office is an extension of a governmental unit, we have a higher duty than a private employer might have in preserving the right to privacy. The standard that a courts use has been the **"balancing test."** The court should ask whether the intrusion into the employee's privacy was reasonable, given the employee's expectation of privacy and the government employer's need to supervise.

Courts have consistently found that there is a reasonable expectation of privacy in the desk and file drawers used exclusively by an employee. Further, some district courts have implied that if a search in someone's desk is for the purpose of uncovering evidence of criminal wrongdoing a search warrant should be obtained, even though the controlling law does not require one.

Elements of the tort of invasion of privacy include the following:

- The intrusion occurs in a place where the plaintiff has a reasonable expectation of solitude.
- The intrusion must be highly offensive to a reasonable person.
- The intrusion must be intentional.

As a general rule, If a search should involve looking into an employee's desk, drawers, purse, file cabinets, etc. **without their verifiable consent,** the District Attorney's office must be contacted to determine if probable cause is sufficient to obtain a search warrant .

Intentional Infliction of Emotional Distress

The tort of infliction of emotional distress can be caused by:

- An act of extreme or outrageous conduct, as perceived by a reasonable person. Spoken or written words are construed as an "act".
- The act must be intended to cause severe emotional distress.

The modern view of this tort is that where the perpetrator of the act intentionally and successfully causes severe emotional distress to the plaintiff. Suggestions to avoid tort suits are as follows:

- Be aware that a given employee may be particularly sensitive.
- Avoid the primary way of running afoul of this tort - always maintain an even temper and avoid unpleasant encounters like the plague.

False Imprisonment

The tort of false imprisonment can be present if the following conditions are present:

- There is an act which, in the perception of the suspect, causes the suspect to feel confined. Words alone may be enough if the auditor represents himself as having the authority to keep the defendant from leaving.
- The auditor must have the intent to confine the suspect.
- The confinement must be to some specific area.

It is not necessary to physically restrain a suspect to be guilty of this tort. The courts have found that a person in a position of authority may intimidate a person into believing that they may not exit a certain area.

Some general guidelines to follow to avoid this tort are as follows:

- Be aware of physical space in encounters with employees, and whether the suspect feels as if he is able to end the encounter by leaving. Ask the suspect to sit down rather than telling them to sit down.
- As far as is practical, leave office doors open or ajar, and make an effort not to use body language the suspect could consider confining. Do not stand in the doorway, block stairs, lean against the suspect's car door, or sit between the suspect and the only way out.

Slander

The tort of slander can be claimed if the following occurs:

- Oral defamation occurs that is transitory in nature.
- If the suspect can show "special damages", which are losses he suffers as a result of the slander, the court will not presume without proof.
- The defamation must be communicated to any third person by the doer of the tort.
- There are two instances where a suspect would not need to show "special damages" to collect. The suspect need only show that the conduct took place.

  - If the speaker accuses the suspect of a crime, the court presumes damages.

  - If the speaker accuses the suspect of conduct unbecoming or having characteristics incompatible with a member of the suspects profession, the court presumes damages.

General rules to avoid slanderous remarks are as follows:

- Before an auditor speaks, he should remember that verifiable truth is the best defense to slander.
- The auditor should be very aware of the surroundings and who may be listening to any statements made.

  The auditor should editorialize and generalize as little as possible. Make statements that are centered around facts and not judgements.

Libel

The tort of libel can occur when the following happens:

- Defamation appears in some physical form and permanent form (i.e. writing).
- The defamation must be communicated to a third party. The third party need not believe the libel - just receive the communication.

Ways to avoid the possibility of committing a libelous act are as follows:

- Do not commit any unsupported negative comments to writing.
- Certainly, do not put into a letter or memo form any negative theories that are not supported by hard facts.

Personal Exposure

One never knows what desperation or mind set exists in people in this high pressure world we live in today. People are killed for little or no apparent reason. While it is very unlikely that an auditor would ever be in physical danger, it is something that should be in the back of the auditor's mind - One never knows for sure when the wrong nerve might be touched, especially when dealing with issues as sensitive and lifechanging as fraud conviction. The auditor should always be sensitive to the mood and level of nervousness of the suspect in a fraud audit, and should not take unnecessary chances. One more compelling reason to keep the county auditor and Audit Manager informed of discoveries is that "there is safety in numbers".

Outside Independent Auditor's Perspective

The following is included to provide information about fraud from the outside independent auditor's perspective. It should be noted that some of the information may have been discussed previously.

Errors and Irregularities

In order to satisfy generally accepted auditing standards, an audit should be conducted to detect material misstatements in the financial statements. Material misstatements may arise because of errors or irregularities. An audit should be designed to detect both. In Statement of Auditing Standards - SAS 53 "The Auditor's Responsibility to Detect and Report Errors and Irregularities", errors are defined as unintentional misstatements, while irregularities are intentional misstatements. An irregularity that is committed by an employee usually has an immaterial effect on the financial statements. On the other hand, an irregularity committed by a member of senior-level management is more likely to be material.

Discovery

When it appears there is an irregularity, the auditor should consider whether the financial statements are materially affected. If the effects of the irregularity are not material, SAS-60 "Communication of Internal Control Structure Related Matters noted in an Audit", says to:

- Notify management of the irregularity (at least one level above the level involved).
- Determine whether there are implications for other phases of the audit.

If the effect is material, or if the effect cannot be evaluated, the auditor should:

- Identify implications for other phases of the audit.
- Discuss the irregularity with management (at least one level above the level involved).
- Attempt to obtain support to substantiate the irregularity and its effect on the financial statements.
- Advise the client to discuss the matter with legal counsel, if laws have been violated.

Communication

The auditor should be satisfied that the audit committee is aware of irregularities (except those inconsequential ones) that the auditor has become aware of. All irregularities (both consequential and inconsequential) that involve the entity's management should be communicated to the audit committee.

Illegal Acts

Although the purpose of an audit is not to detect illegal acts, an auditor should be aware that such acts could occur. SAS-54 "Illegal Acts by Clients", defines illegal acts as "violations of law or governmental regulations". In order to determine the auditor's responsibilities for detecting illegal acts, they are classified as either those with a direct effect on the financial statements or those with an indirect effect on the financial statements.

Illegal Acts With Direct Effects

The auditor's responsibility for detecting illegal acts relating to laws and regulations having a direct and material effect on the financial statements is the same as the responsibility relating to the detection of error and irregularities. The auditor must design the audit to provide reasonable assurance for detecting such acts.

Illegal Acts With Indirect Effects

Most laws and regulations have only an indirect effect on the financial statements. Illegal acts of this type are generally related to the operations of the organization rather than to the financial and accounting aspects of the entity. SAS-54 lists the following as examples of specific information that may raise questions about the existence of illegal acts.

- Unauthorized transactions, improperly recorded transactions, or transactions not record in a complete or timely manner in order to maintain accountability for assets.
- Investigation by a governmental agency, an enforcement proceeding, or payment of unusual fines and penalties.
- Violations of laws or regulations cited in reports of examinations by regulatory agencies made available to the auditor.
- Large payments for unspecified services to consultants, affiliates, or employees.
- Sales commissions or agents' fees that appear excessive in relation to those normally paid by the client or to the services actually received.
- Unusually large payments in cash, purchases of bank cashiers' checks in large amounts payable to bearer, transfers to numbered bank accounts, or similar transactions.
- Unexplained payments made to government officials or employees.
- Failure to file tax returns or pay government duties or similar fees common to the entity's industry or the nature of the business.

Audit Procedures - Suspicion of Illegal Acts

If an auditor is aware of information concerning an illegal act, the auditor should (1) understand the nature of the act, (2) understand the circumstances surrounding the act, and (3) obtain sufficient information to evaluate the effects of the act on the financial statements. The auditor should deal with management at least one level above those involved.

When management cannot provide sufficient information to demonstrate that an illegal act did not take place, the auditor should:

- Consult with the entity's legal counsel or other specialists.
- If necessary, perform additional procedures such as:
  - Examine supporting documentation and compare with accounting records.
  - Confirm information with other parties.
  - Determine if the transaction has been properly authorized.
  - Consider whether similar transactions have occurred and attempt to identify them.

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Discovery of Illegal Acts

When an illegal act has occurred or probably occurred, the auditor should evaluate the effects of the act. The possible loss arising from the illegal act should be evaluated to determine whether the amount is material. The need for accrual and /or disclosure in the financial statements should be evaluated. The illegal act should also be evaluated to determine other aspects of the engagement are affected.

Communication

An auditor should assure himself that an illegal act has been communicated to the audit committee or to individuals with equivalent responsibilities. Notification of the occurrence of an illegal act to parties other than management and the audit committee is not required; however, SAS-54 notes that under the same circumstances the auditor may be called upon to inform another party of an illegal act. The auditor may find it advisable to contact legal counsel before illegal acts are disclosed to outside parties.

When And Where The County Auditor's Duties And Authority Stop

In the December 1995 issue of Government Finance Review, the article *Fraud Happens: A Primer on Lying, Cheating and Stealing*, by Arthur A. Hayes, Jr., addresses the issue of when and where the auditor's duties and authority stop as "The principal role of auditors is to report. It is important that they not lose sight of their primary focus on auditing, for it is all too easy for auditors to initiate decisions and actions that are not their responsibility. The decision about prosecution is in the purview of the officials having the authority to prosecute: District Attorneys, General or United States Attorneys, who will be concerned that the auditor be able to prove that fraud exists in a program or agency to their satisfaction."

The auditor's responsibility once fraud is determined is to:

- Preserve Evidential Matter - this was discussed under the section "Suspected Fraud Discovered Through Routine Audit Procedures"

- Notify the District or County Attorney to review the supporting documentation. If the District or county auditor concurs with the auditor that a fraud has occurred, then:
  - If the fraud is an employee fraud, the District or County Attorney will notify the Texas Rangers to assist or conduct the investigation.
  - If the fraud is a non-employee fraud, the District or County Attorney will notify the proper agency or authority.

- Review the internal controls to determine what steps need to be made to improve the internal controls to prevent the fraud from happening in the future.

In conclusion, Arthur Hayes, Jr. notes "Auditors may be disappointed in the decisions of these authorities not to pursue a case which they feel is air tight, but they should not be discouraged; their efforts are essential to the protection of public assets. Audit findings can serve to stimulate public awareness of serious shortcomings in the administration of programs, and their recommendations are key steps in improving controls to prevent future problems. Even if there is not a prosecution, the auditor's efforts may serve to deter individuals otherwise tempted to abuse their trust, or may be sufficient evidence for noncriminal disciplinary action against the subject."

It is recommended that each auditor discuss the issue of fraud detection and reporting with their District and County Attorneys to determine policies and procedures for their own particular county. Review by the District Judges of the policies and procedures regarding fraud may also provide additional information, and will provide information to the District Judges of what policies and procedures you, as the auditor, will be following once fraud is detected.

The above referenced article in the December 1995 Government Finance Review by Arthur Hayes, Jr. is included in appendix 10.2 of this Guide to help provide awareness as to how fraud may happen. ***Mr. Hayes has graciously granted permission to have his article reprinted in this guide.***

Other reference materials are Statements on Auditing Standards Numbers 47, 53, 54 & 55. Also, the Government Finance Officers Association publishes a hand out "An Elected Officials Guide to Internal Controls and Fraud Prevention" which can be purchased from GFOA.

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REPRODUCIBLE FORMS

Appendix 10.1 contains photocopies of reproducible forms which can be used by county auditors in accomplishing their audit responsibilities. They are only generic samples which can be added to or changed in any way to fit specific needs.

The forms reproduced here were originally legal size forms (8 1/2" x 14") which have been reduced in size by 77%. In order to convert them back to their full size, the photocopier need to be set at an enlargment factor of 129%.

Auditee:			
Prepared by:	Date:	Updated by:	Date:
Updated by:	Date:	Updated by:	Date:
Updated by:	Date:	Updated by:	Date:
Updated by:	Date:	Updated by:	Date:

1. COMMUNICATION: Consider the extent of formal communications occurring in the office such as written policy statements, codes of conduct, procedure procedure manuals, organization charts, organized informational meetings, etc.

2. MANAGEMENT OVERSIGHT: Discuss management's oversight of setting standards, reviewing (monitoring) performance, and applying corrective and reinforce-ment procedures. Consider the following areas:

a. Managements overall philosophy about controls including their focus on areas of risk

b. The extent to which the accounting system and related system of internal accounting control is documented (i. e. the existence of defined standards).

c. The timeliness of reports produced, reconciliations performed, and corrections to errors detected through the internal control system. Are important things "put-off".

d. The suitability, availability, reliability or even existence of management reports, and the view of management concerning these reports.

e. The extent to which action has been taken historically, in response to audit reports issued by the County Auditor's office

Auditee:

3. PLAN OF ORGANIZATION: The plan of organization can vary from office to office according to its size and complexity. Generally organization encompasses checks and balances, quality of personnel, delegation of authority and scope of responsibilities. The plan of organization should provide for segregation of incompatible functions.

4. PERSONNEL ENVIRONMENT: Consider whether standards, policies and procedures exist for selecting, training, appraising and compensating employees.

5. DELEGATION OF AUTHORITY: Consider whether there is a clear understanding of the authority and responsibilities delegated and the relationships individuals have with respect to others in the organization (e. g. as set forth in an organization chart, job descriptions, etc.). Are personnel informed of the policies, procedures, and activities that directly or indirectly affect their individual responsibilities?

CASH FLOW CONTROL QUESTIONNAIRE

Office _____ Date _____

Auditor _____

Account Name _____ Bank _____

Account Numbers: Purpose of Account _____

Bank account _____ _____

General ledger _____ _____

Authorized signers: _____

_____ _____

_____ _____

_____ _____

1. Describe the types of payments for which receipts are issued?

2. Are the receipts computer generated or are they manual receipts?

3. If manual receipts are ever utilized to any degree,

   a. Are they prenumbered?

   b. Are they purchased, issued and controlled through the County Auditor's office?

   c. If manual receipts are temporary (used when the computer is unavailable) describe the what happens to the manual receipt after it is entered in the computer system.

4. Which employees receive money from the public? (For small offices, describe what happens with receipts when the normal cashier is out on vacation, sick leave, lunch or coffee break.)

5. If multiple employees receive money, describe the security and separateness of each "cashiers" accumulated receipts (i.e. separate cash drawers/boxes, lock security, etc.).

6. If multiple employees receive money and they utilize computerized receipts, describe their password security and procedures to assure accountability (i.e. common knowledge of each others passwords, leaving terminals unattended, etc.)

7. What is the office's policy concerning employees cashing checks out of change funds or accumulated undeposited cash receipts?

8. Describe the method of accounting for all receipts issued and who is responsible for this accounting.

9. Describe how receipts are reconciled to deposits and who accomplishes the reconciliation.

10. Describe the procedures when a receipt is voided.

11. How often are deposits made at the bank and how does the money get to the bank?

12. Where is undeposited cash kept
    a. On breaks and lunch times?

    b. Overnight, if not deposited each night?

13. Describe the physical security for the checkbook.

14. Describe the security of any check signing paraphanelia (stamps and signature plates)

15. Are dual signatures required on all checks?

16. Is the bulk of the receipts in cash, checks or money orders?

17. If the office receives receipts in the mail,

    a. Who opens the mail?

    b. Are cash receipts listed by the person opening the mail?

    c. If "b." is yes, what is done with the list?

    d. Are receipts mailed to the senders?

Checks and balances

It pays (and saves) to protect your office

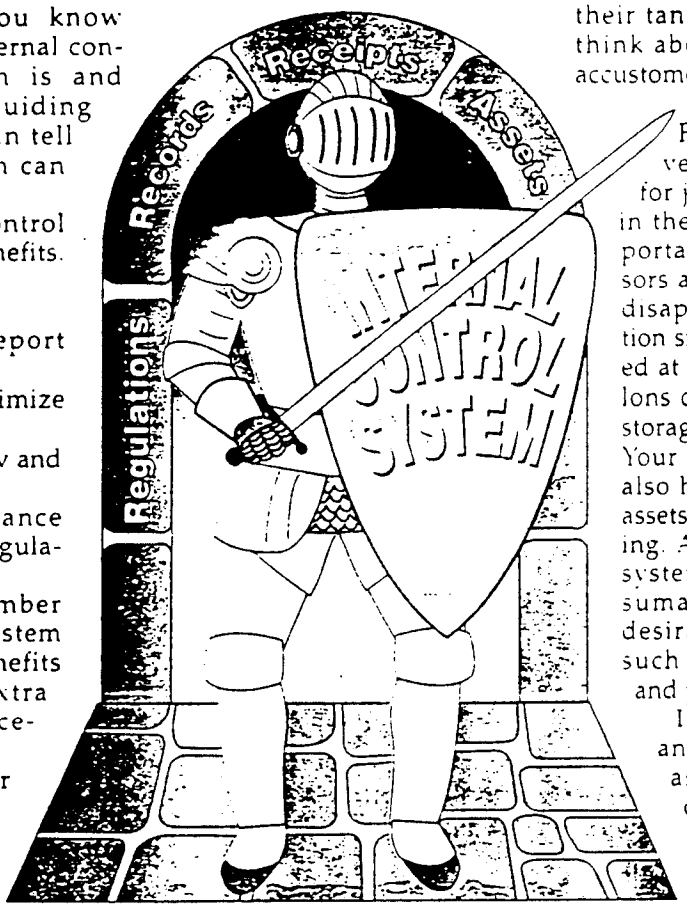
Now that you know what an internal control system is and what the guiding principles are, we can tell you what the system can actually do for you.

A good internal control system has several benefits. It allows you to:

1. safeguard assets;
2. record and report properly;
3. prevent and minimize errors;
4. promote efficiency and effectiveness; and
5. ensure compliance with laws and regulations.

The key to remember here is that a good system will provide these benefits without creating extra paperwork and procedures.

Let's take a closer look at these benefits.



1. Safeguard assets

When we think of assets, the first item is money—cash, checks—in the bank. How many errors would go undetected without a good system of checks and balances? How much money would disappear if no one was accountable?

You can take several steps to ensure your assets—especially money—are safeguarded. These actions include:

- locking all offices and limiting access to keys;
- locking up and limiting access to blank checks and receipts;
- using a processing lock box (a bank processes receivables under a government's direction);
- purchasing burglary insurance; and
- bonding all employees who handle cash.

Even offices that do not handle money have internal control systems in place to safeguard their tangible assets. We don't think about it because we are accustomed to seeing safeguards in our everyday lives. For example, how many vehicles would be taken for joyrides if we left keys in the ignition? How many portable welders, compressors and power units would disappear from a construction site if they weren't hoisted at night? How many gallons of fuel would be lost if storage tanks weren't locked? Your city and county offices also have valuable tangible assets that require safeguarding. A good internal control system will safeguard consumable supplies that are desirable for personal use, such as gasoline, software and postage.

It is important to have an inventory of tangible assets by office or department. As you purchase or acquire new property, update your inventory list. Although audits—especially surprise audits—are an aid in accounting for money or property, don't rely solely on them to reveal missing funds or tangible assets. Instead, consider internal periodic reviews of your inventory.

2. Record and report properly —and 3. Prevent and minimize errors

How do you go about ensuring a good system of internal

control is in place? Start by evaluating your current system to ensure it includes sound procedures and separated duties for the people performing them. Remember that no one person should handle a related transaction from start to finish. For example, you would not want the same person doing all of the following:

- distribute blank receipts to staff for handling money;
- collect money from the public and issue receipts;
- make the bank deposits;
- approve the bank deposits;
- make cash entries into journals and ledgers;
- make entries into taxpayer accounts, dockets or case files;
- reconcile bank statements; and
- make monthly receipt and expenditure reports.

In this example, at least three employees are needed for a good separation of duties so that you prevent opportunities for fraud and embezzlement, and record what you really take in from the taxpaying public. Two other things to take note of: number your receipts so that you can account for them and issue separate cash drawers to each employee. This way, if a cash drawer is short of money, you have automatically minimized placing all of your employees under suspicion, and innocent staff members will feel protected.

For other tangible assets, make sure that whoever signs for new inventory is not the same person who records or audits your inventory lists. It helps to ensure that inventory will not "walk away."

An added challenge for many offices is not having enough staff to divide the duties of cash handling, keeping the books and authorizing transactions. If your office does not have enough employees to divide duties, you may need to look into more frequent direct supervision of policies and procedures, and regular internal or periodic external audits. Supervision will vary from area to area in your offices, but an adequate amount within those individual areas will help catch errors early.

All of these tips should help you record and report properly. And, if you record and report properly, you will greatly minimize a chance for error.

4. Promote efficiency and effectiveness

If you have an internal control system, you've probably taken the time to review the duties and processes within your office. If you don't have one, implementing an internal control system will give you this opportunity. Because an internal control system is something that should be continually monitored, you will not only have the chance to figure out the most effective way to do things, you can take a look at the efficiency of the system as well. Following are some ideas you may want to examine for your offices.

Some local governments have strengthened their internal control systems by adopting a central cashier position where one location serves as the collection area for all offices, such as when the county treasurer or city treasurer serve as the central cashier. The advantages for individual offices having one central cashier are that they do not have to worry as much about:

- maintaining change funds;
- providing security for money;
- providing cash drawers to each individual handling cash or balancing cash drawers daily;
- establishing and maintaining an internal control system for the money;
- making deposits for the treasury;
- being audited for their cash handling process;
- maintaining an inventory of receipts; and
- dealing with returned checks.

Another idea is to closely look at using a lock box service for mail receipts to accelerate the collection of your funds and ease some of your administrative work. Three steps take place with lock box processing: (1) the government assigns a post office box number to bills generated, (2) a third party, such as a bank, picks up the receivables addressed to that post office box, and (3) the third party processes the receivables as directed by the government.

Discuss the benefits that a lock box provides with the individuals who collect, report and invest your funds. You may discover that it increases accountability of the funds, and greatly decreases money handling—and relieves the security that accompanies money handling—for your different departments. The cost of a

Economic Assistance presents women's business development seminar

The Comptroller's Economic Assistance Division will present a one-day seminar this spring for business and professional women. The seminar, "Blazing New Trails: Women and Business," will be held at the Plaza San Antonio Hotel, 555 South Alamo in San Antonio on May 25. Information at the seminar will include business creation, business development, financing, future trends, and the recent Comptroller report, *Forces of Change*. Comptroller John Sharp will present an overview of *Forces of Change*. For more information, call 1-800-531-5441, ext. 5-0350; in Austin, call 475-0350.

lock box may also mean more money in the bank through rapid deposits, which earn more interest for your city or county and make it more readily available for investments.

Rapid deposits also increase the likelihood that offices will remain current on their workload. Employees will prepare their bank deposit slips and remittance forms much sooner. If you are making bank deposits once a day or twice a week, you may want to see if you should increase the frequency of those deposits. It may mean a rescheduling of work to ensure deposits and remittances have priority. Calculate the additional net earnings that could be made to determine if this is a cost-efficient and cost-effective strategy for your office. At the very least, every city and county should investigate the benefits of rapid deposits in interest-bearing accounts.

In addition, rapid deposits promote efficiency in safeguards. Individual city or county offices no longer have to worry about the money once they turn it over to the treasurer who becomes responsible for the deposit of the funds. Once money is deposited, the treasurer no longer has to worry about safeguarding it in the office because the bank takes over by protecting the funds. Remember, it is easier to safeguard an account at the bank than it is to safeguard cash and checks in your individual offices.

5. Comply with the law and regulations

When you monitor your internal control system, it also gives you a chance to review your procedures and policies to see if they are in line with laws and regulations. You may want to have an independent auditor evaluate your system.

Independent auditors evaluate the internal controls in place to determine whether there are any weaknesses that would prohibit them from relying on the controls when they audit your financial statements. You can request that they audit your internal control system for accountability, paying close attention to the laws you are required to follow. For example, as a county you may want to look closely at laws that require separate funds for specific or dedicated use. If revenues for a fund are restricted in use, you can ensure these restrictions through appropriate accounting procedures and regular audits. County offices, in particular, may want to also ensure compliance with the Rapid Deposit statutes as they apply.

As a city or a county government official, you may also want to ensure that you are meeting at least the minimum amount of required bonds as stated in the statutes. You may decide to increase the amount of bonds to more closely coincide with the volume of money and the value of tangible assets your offices acquire or purchase. Many local officeholders are held personally liable for the money their offices handle. Others can be personally liable if they are found to be negligent—this includes failing to set up adequate checks and balances.

For more information

The public expects you to safeguard the money and assets entrusted to your office, so give your internal control system a check-up by using the Internal Control Checklist that follows.

You should be able to answer "yes" to almost every question. If you answer "no" to a question, consider making changes to ensure accountability.

For more information on internal control systems, call the Local Assistance Division at 1-800-531-5441, ext. 3-4679; in Austin, call 463-4679. We will be happy to answer your questions. ▲

Contributing to this article:
Gordon Thomas, CPA

Bond requirements for public officials

The law requires that many public officials be adequately bonded as part of their elected or appointed positions.

Following is a list of some of those positions. If you need more information on these or other positions not listed, please call the Local Assistance Division at 1-800-531-5441, ext. 3-4679; in Austin, call 463-4679.

County Commissioner	V.T.C.A., Local Government Code §81.002
County Judge	V.T.C.A., Government Code §26.001
Justice of the Peace	V.T.C.A., Government Code §27.001
County Clerk	V.T.C.A, Local Government Code §§82.001,82.003
District Clerk	V.T.C.A., Government Code §51.302
Tax Assessor-Collector	V.T.C.A., Tax Code §6.28
County Treasurer	V.T.C.A., Local Government Code §83.002
County Auditor	V.T.C.A., Local Government Code §84.007
Sheriff	V.T.C.A., Local Government Code §85.001
Constable	V.T.C.A., Local Government Code §86.002
County Attorney	V.T.C.A., Government Code §§45.001, 41.012
District Attorney	V.T.C.A., Government Code §§43.002, 41.012
Criminal District Attorney	V.T.C.A., Government Code §44.002
Any Municipal Officer	V.T.C.A., Local Government Code §22.072
Mayor and Commissioner	V.T.C.A., Local Government Code §24.024
City Manager	V.T.C.A., Local Government Code §25.029
City Treasurer	V.T.C.A., Local Government Code §22.075
City Secretary	V.T.C.A., Local Government Code §22.073
City Attorney	V.T.C.A., Local Government Code §24.051
Marshall	V.T.C.A., Local Government Code §22.076
Police Officer	V.T.C.A., Local Government Code §341.001

Internal control checklist

	YES	NO	NA	COMMENTS
General				
1. Does your office have a procedures manual?				
2. Does the procedures manual cover all duties and responsibilities?				
3. Do you periodically review and update your procedures manual?				
4. Are the officeholder's and employees' duties and responsibilities fixed?				
5. Do you periodically rotate duties?				
6. Do you require all employees to take vacations?				
7. Is the work of employees on vacation performed by someone else during their absence?				
8. Are all employees adequately trained?				
9. Do you periodically assess training needs?				
10. Is the officeholder appropriately bonded?				
11. Are other employees appropriately bonded?				
12. Do you periodically review the adequacy of the bonds?				
13. Are employees performing their duties appropriately?				
14. Is the workload current?				
15. Is the office understaffed?				
16. Do you have an inventory of all tangible assets?				
17. Is the inventory up-to-date?				
18. Is responsibility for the assets fixed?				
19. Do you periodically review your inventory and account for all assets?				
20. Does an internal/external auditor periodically audit your office?				
21. Do you implement the auditor's appropriate recommendations?				
22. Do you implement the auditor's recommendations on a *timely* basis?				
Receipts				
1. Are receipts filled out when money is received?				
2. Are all receipts sequentially prenumbered?				
3. Do you have adequate control over unissued receipts?				
4. Do you periodically account for all unissued receipts?				
5. Are all receipts dated and signed (or initialed) by the persons who issue them?				
6. Are your receipts at least in three-part form?				
7. Is a copy of the receipt given to each person paying money?				
8. Is a copy of the receipt kept by your office?				
9. Is a copy of the receipt given to the accounting office?				
10. Do receipts contain adequate space for information?				
11. Are employees instructed to ensure that the person paying appropriately completes a check before they issue a receipt?				
12. Does your office have a policy of immediately stamping all checks with a restrictive endorsement?				

	YES	NO	NA	COMMENTS
13. If applicable, do you compare receipt amounts with supporting documentation to ensure the amounts are correct?				
14. Does each person receiving cash have a separate cash drawer or register?				
15. Is access to cash drawers or registers restricted to the persons responsible for them?				
16. Does each person with a cash drawer or register balance out daily?				
17. Is the balancing verified by someone who is not taking in money?				
18. Are these persons collecting the appropriate amounts? (e.g., according to statutes,ordinances.)				
19. Is each person receiving money aware of the amounts that should be collected?				
20. Do you periodically review the collected fine/fee amounts?				
21. Does your office adequately safeguard money until it is deposited or remitted?				
22. Does someone other than the person receiving money prepare the bank deposit?				
23. Are bank deposits or remittances made daily?				
24. Do you periodically compare receipt copies with bookkeeping entries?				
25. Do you account for change funds?				
26. Do you periodically review the adequacy of change fund amounts?				
27. Does your office open mail daily?				
28. Is mail opened by someone other than the persons taking in office receipts?				
29. Does the person opening the mail prepare a record of the checks and cash received?				
30. Does your office have a policy of immediately stamping checks received through the mail with a restrictive endorsement?				
31. Is the bank deposit prepared by someone other than the person opening the mail?				
32. Are mail receipts deposited or remitted daily?				
33. Does your office have a system to account for installment or periodic payments?				
34. Does your office have a system to keep up with payment due dates?				
35. Are all outstanding amounts known and accounted for?				
36. Is there a control total for all outstanding amounts?				
37. Do you periodically compare the control total with subsidiary records?				
38. Is there a sufficient amount of double-checking of other employees' work?				
39. Does the amount of double-checking increase/decrease when staff size decreases/increases?				
Disbursements				
1. Are all disbursements made by check?				
2. Are all checks sequentially prenumbered?				
3. Are all checks preprinted with the name of the entity and other appropriate information, such as the name of the office and the name of the officeholder?				

	YES	NO	NA	COMMENTS
4. Do you account for and adequately safeguard all unused checks?				
5. Are all voided checks marked "void" and accounted for?				
6. Are checks prepared only when supporting documentation is present and after such documentation is verified?				
7. Are checks prevented from being made out to "cash" or "bearer"?				
8. Is the payee line completed on all checks prior to approval?				
9. Are checks approved by someone other than the person responsible for the bookkeeping?				
10. Are checks prevented from being presigned?				
11. Do you keep authorized check signatures to a minimum?				
12. If a "stamp" or "check-signing" device is used, do you safeguard it and restrict access to it?				
13. Does your office prepare and mail (or deliver) checks timely?				
14. Are checks mailed without returning them to the person who approves them or who does the bookkeeping?				
15. If applicable, are supporting documents, such as invoices and statements, canceled upon payment?				
16. Is there a sufficient amount of double-checking of other employees' work?				
17. Does the amount of double-checking increase/decrease when staff size decreases/increases?				
Bank Accounts				
1. Does your office maintain only the minimum number of bank accounts?				
2. Are balances appropriately safeguarded according to provisions in the county depository contract or FDIC Insurance?				
3. Does your office reconcile bank accounts promptly after receiving bank statements?				
4. Are reconciliations done by someone other than the person who prepares bank deposits and approves checks?				
5. Does the person who reconciles the bank statements receive those statements unopened from the bank?				
6. Do you compare deposits shown on the bank statement with accounting records as to date and amount?				
7. Do you verify the amount of service charges?				
8. Do you account for all canceled checks?				
9. Do you compare canceled checks with accounting records as to check number, date, amount and payee?				
10. Do you examine canceled checks for alterations?				
11. Do you examine canceled checks for unauthorized signatures?				
12. Do you examine canceled checks for irregular endorsements?				
13. Are items returned or rejected by the bank properly investigated and accounted for?				
14. Are completed bank reconciliations reviewed and				

	YES	NO	NA	COMMENTS
approved by someone other than the person performing the original reconciliation?				
15. Is there a time period or date printed on the checks, after which they become void?				
16. Are outstanding checks appropriately handled and accounted for once they become void?				
17. Does your office policy prohibit pre- or post-dating of checks?				
Accounting, Bookkeeping, Reporting				
1. Does your office maintain a bookkeeping system to account for all financial-related transactions?				
2. Do you maintain books of original entry?				
3. Do you maintain adequate subsidiary records?				
4. Does your office enter transactions daily?				
5. Are transactions entered from appropriate sources (e.g., receipt copies, check copies)?				
6. Do you verify daily entries for mathematical accuracy?				
7. Are entries periodically reviewed by someone other than the person making them, comparing the entries with appropriate source documents?				
8. Do you maintain a good audit trail for all transactions from source documents to accounting records, and from accounting records to source documents?				
9. Do you maintain docket books as required by law? (Municipal, JP, District, and County Courts)				
10. Is all required information entered into the docket books? (Municipal, JP, District, and County Courts)				
11. Are entries to docket books current? (Municipal, JP, District, and County Courts)				
12. Do you periodically compare the docket books to source documents and other accounting records for accuracy? (Municipal, JP, District, and County Courts)				
13. Is the bookkeeping performed by someone other than the persons receiving cash, preparing bank deposits and approving disbursements?				
14. Does your office prepare and submit reports timely?				
15. Do you compare reports against accounting records for accuracy?				
16. Are reports reviewed and approved by someone other than the person preparing them?				
17. Are reports audited monthly by the county/city/other internal auditor?				
18. Is there a sufficient amount of double-checking of others' work?				
19. Does the amount of double-checking increase/decrease when staff size decreases/increases?				
Supplies				
1. Are requisitions required to obtain supplies?				
2. Does your office have procedures and safeguards to prevent unauthorized use of supplies, especially those that are desirable for personal use?				
3. Are procedures in place to transfer unneeded supplies to others who can use them?				
4. Do you rotate responsibilities for supplies to avoid collusion?				

APPENDIX 10.8

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
WHY PERFORMANCE AUDITS PRECEDING SCANDALS WERE IGNORED

The Spring, 1996 edition of The Government Accountants Journal contained a report on the Association of Government Accountants Task Force *Why Performance Audits Preceding Scandals were Ignored.* While this Guide is not directed at performance auditing, this article was included in the appendix, because the knowledge based on the results of the Task Force's study can be applied by anyone wishing to communicate audit results.

Why Performance Audits Preceding Scandals were Ignored has been reproduced in APPENDIX 10.8 with the consent of the Association of Government Accountants (AGA). Further information concerning this article or the AGA can be obtained from their offices at The Association of Government Accountants, 2200 Mount Vernon Avenue, Alexandria, VA 22301-1314.

Report of the AGA Task Force on

Why Performance Audits Preceding Scandals Were Ignored

By AGA Task Force Members:

Peter Babachicos

Daniel Kyle

Karen McKenzie, CGFM, Chair

Gary Palmquist

When surveyed as to the perceived importance of emerging issues to be addressed by AGA, members ranked as most important the completion of a research project to determine why audits were ignored in areas where subsequent scandals occurred. As a result, our task force was commissioned with the following objectives: (1) to determine the extent to which audit findings were ignored preceding scandals; (2) identify factors contributing to the audit findings being ignored, (3) consider actions to increase the use and usefulness of audit findings and (4) to prepare recommendations to prevent audit findings from being ignored, potentially allowing scandals to develop. In identifying factors contributing to ignored audit findings, the task force had a special interest in whether auditors addressed the real causes of problems detected during an audit. This report summarizes our efforts to compile meaningful information regarding why performance audits were ignored preceding scandals.

Methodology

The task force's working definition of scandal is:
an event or series of events, either intentional or unintentional, which results in embarrassing revelations about public officials and/or the programs they manage.

Given that definition, we agreed to associate scandals with media attention. We believed media attention was the best means of identifying instances where performance audit findings had been ignored and how the issues presented in those findings ultimately developed into a government scandal. We acknowledge that many potentially scandalous issues may be addressed as audit findings and never attract media attention. This is due in part to the myriad of events vying for limited space in media coverage. Moreover, we believe the media may, at times, devote seemingly unwarranted attention to an issue which had been addressed as a performance audit finding and "manufacture" a scandal by cultivating the public's interest. However, we had to isolate a means of collecting relevant information regarding the occurrence of scandal. Media coverage was agreed to be our primary vehicle.

Data collection was via mail survey, which was sent to the membership of two professional auditor organizations. As displayed in *Table 1*, 216 of our subjects were from the National Intergovernmental Audit Forum (Audit Forum or NAF) and 194 were from the National Association of Local Government Auditors (NALGA).

Special thanks to: Susan Dobson, Les Gibson and Gary McCrary for their support activities throughout the project.

By Katherine Thompson, CIA, CISA
Audit Supervisor, US Environmental Protection Agency Office of Inspector General

At some point in recent accounting history, auditing grew from an examination of the fairness of financial statements to auditing the performance of management. The federal government, along with at least 16 states and numerous local governments, are either using or preparing to use performance audits.

But what is performance auditing? Sometimes known as an operational audit, program audit or management audit, *Government Auditing Standards* define a performance audit as:

The standards go on to say that performance audits include economy and efficiency and program audits. In short, performance audits identify ways government can work better and cost less. By taking a thorough, top-to-bottom look at every operation, performance audits measure economy and efficiency, effectiveness of services and then recommend appropriate changes. Performance audits uncover waste and fraud. Ultimately they change the way government works.

What does performance auditing mean to the practicing professional? Here are some definitions provided by leaders in government performance auditing:

Gerald R. Silva, CGFM, City Auditor, City of San Jose, California:

Kurt Sjoberg, CGFM, State Auditor of California:

Francis E. Reardon, CGFM, Auditor General, US Army:

What is the mission of the activity? Is it still needed?
Is management achieving its mission?
How does it know it is achieving its mission?
Can it be more effective in achieving its mission?
Is management achieving its mission as effectively as possible?

Performance auditors must make sound, workable recommendations to make government work better for less. But why is a performance auditor any better at making government more effective and efficient than a government manager?

According to Dr. Leo Herbert, author of *Auditing the Performance of Management*, at the beginning of the audit, the auditor has "no idea where to go or what to do." This may be a great advantage for the open-minded performance auditor. Unencumbered by procedure manuals, system limitations and "how we have always done it" attitudes, the performance auditor is probably more receptive to ideas about how to do things better. And the seasoned performance auditor has the great advantage of working with more organizations (and thus having a better working knowledge of more systems) in a few years than most managers do in a career.

In the opinion of many auditors, there is another reason that performance auditors have been more effective: the placement of the auditor outside (or at the top) of the organizational chart. Unlike the manager, the auditor has the advantage of being able to easily cross organizational lines, both vertically and horizontally. Thus, if the auditor is auditing a process such as repairing aircraft, he or she can evaluate the entire process from ordering the part to repairing the aircraft, rather than just evaluating the ordering process.

In very large organizations with multiple activities performing the same process, the auditor's ability to cross departments also provides a big advantage. The auditor can contrast how efficient and effective these activities are and use the best procedures and processes to make the whole organization more efficient.

Does performance auditing sound a lot like re-engineering government? It should. It is. And to continue to be successful, performance auditors must ask the questions managers may not want to ask: should this function exist? Do we still need it? An objective assessment of how well the function of government is being accomplished is at the heart of effective performance auditing.

These subjects received a cover letter on AGA letterhead requesting their participation and assuring them of anonymity. The letter encouraged subjects to (1) respond to a brief demographic information sheet (at least) and (2) provide information regarding two actual performance audits where the audit identified issues of potential fraud, waste or abuse. If possible, subjects were asked to send information for two different scenarios (case types). One scenario was that the audit identified issues which subsequently appeared as a government scandal in media reports; the other was that no scandal appeared in the media regarding issues identified by the audit. Subjects were also encouraged to send any supporting documents, media coverage, etcetera, along with their responses. Because subjects were encouraged to return the demographic information sheet even if they had no case information to share, room was provided for subjects' comments regarding perceptions on (1) why performance audit findings may be ignored and (2) whether specific aspects of the audit process contribute to management's failure to use audit reports to mitigate the impact of scandalous publicity on an audited matter.

Although we received responses with the aggregate experience of 3,788 performance audits over the past three years, responding auditors had widely varied experience levels. What we considered most interesting was that of these 3,788 performance audits conducted over the past three years by our 89 responding auditors, only 27 cases were identified where reported audit findings were not corrected and subsequently appeared as government scandal in the media.

We have focused on providing information compiled from the audit case sheets returned, with particular interest in the differences between cases with no media reports of scandal and cases which did have media reports of scandal.

Performance Audit Case Sheet and Summary of Results

The Performance Audit Case Sheet was designed to collect information di-

Table 1
Subjects and Response Rates

Level of Government	Member List	Number Mailed	Number Returned	Response Rate
Local	NALGA	194	71	36.6%
Local	NAF	52	19	36.5%
State	NAF	67	26	38.8%
Federal	NAF	97	37	38.1%
TOTAL		410	153	37.3%

cess to audit findings before official audit report issuance, (3) parties who used audit findings to initiate corrective action or seek legal remedies, (4) role played by parties responsible for ensuring corrective action on reported audit findings and (5) auditor's presentation of audit findings.

Our intent was to gather evidence of differences between actual performance audit cases where the audit identified issues of potential fraud, waste or abuse, which subsequently appeared as a government scandal in the media versus such cases which did not result in media reports of government scandal. Twenty-six of our 153 responding auditors returned a total of 35 case sheets. Of those, the number of cases with no media reports of scandal was eight and the number of cases with media reports of scandal was 27.

We found empirical evidence that in cases where the performance audit identified issues of potential fraud, waste or abuse without resulting in media reports of government scandal: (1) report distribution was greater; (2) more parties had access to audit findings before official audit report issuance and (3) more parties used audit findings to initiate corrective action or to seek legal remedies. We asked the auditors to reply to these issues of distribution, access and use of audit findings with regard to middle management, top management, oversight or legislative parties, the media and others. The only area of significant differences in replies between case types was the media's receipt of the report. We found that report distribution to the media is higher in cases which resulted in media reports of government scandal

In addition, our results show that in cases where the performance audit identified issues of potential fraud, waste or abuse without resulting in media reports, parties responsible for ensuring corrective action on reported audit findings played a more positive role in the audit process. However, our results are with regard to the "responsible parties" issue as a whole. More detailed analysis could not identify any single attribute of the "responsible parties" issue as being significantly different between the two case types. Interestingly, our evidence did not find a significant difference in response between the two case types to issues regarding the auditors' presentation of audit findings. That is, regardless of case type, responding auditors did not identify weaknesses within the auditors' presentation process.

Summary of Written Comments

Case Sheet Comments.
The end of each Performance Audit Case Sheet read as follows

In terms of this case, please provide your comments on what contributed primarily to the success/failure of the audit process (attach additional sheets, if necessary). We would also appreciate copies of media coverage.

Most case sheet comments suggested that audit reports were not ignored as a result of the audit process. This is consistent with the findings of our case sheet response analyses discussed above. Miscellaneous weaknesses of the audit process, as commented on by one or two responding auditors, included lack of (1) an audit resolution, (2) follow-up process, (3) a strong audit committee, and (4) independence.

Table 2
Indicators of Audit Report Usefulness

Audit Structure and Scope

Are audit reports issued to highest level of management? Or to oversight committee (if one exists)?

Does top management and the organizational culture support the audit process?

Are staff resources, including training, sufficient for needed audits?

Are audits perceived by management as being helpful?

Is there unrestricted access to the audit area and the audit scope determination?

Does audit scope include evaluation of issues management considers its domain?

Does the audit process adhere to appropriate procedural guidance and applicable audit standards?

Finding Recommendation Development and Reporting

Do work papers adequately support findings/recommendations?

Are findings/recommendations relevant and significant?

Are reported issues meaningful and easy to understand?

Are impacts fully developed to demonstrate existence of real problems?

Are recommendations presented to those able to take action?

Are management's costs/benefits of implementing recommendations addressed?

Are faster/less-costly actions considered for the interim?

Follow-up System

Are significant findings promptly tracked and formally resolved?

Is recommendation implementation validated by audit?

Are financial and other resources available for timely implementation of recommendations?

gard to the auditor's communication of findings and recommendations to report recipients. One comment promoted greater efforts to "sell" the audit recommendations. In contrast, another commented that the auditor's effort to make findings and recommendations more palatable to management often makes the recommendations less dramatic or

ment. In addition, responding auditors commented that audit reports often have too many findings, mixing important and lesser findings, thus diffusing impact for management's attention.

With regard to the specific issue of internal control, some commented that management has difficulty

ings are based on hypothetical situations and theory. Management is described as reactive rather than proactive, with no motivation to act unless there is a real, demonstrated problem (e.g., embezzlement of funds).

A related issue, extending well beyond internal control evaluation, is the auditor's ability to communicate highly technical problems to persons with a more general technical knowledge who were in positions of authority to take action. Moreover, some commented that the length of time between the identification of a finding and the distribution of the final report reduced the utility of the report.

Responding auditors' comments indicate it is, certainly, necessary that findings be communicated to the appropriate party responsible for corrective actions. However, one comment explained that the root cause of the problems was not addressed in the audit report, but involved administrative/managerial persons having responsibility for activities they may not have been qualified to perform. In addition, some of the audit suggestions were not specifically presented to or accepted by persons in positions of responsibility or authority to correct the problems.

Some took a more optimistic tack and commented on reasons for slow implementation, rather than no action. Included among the many reasons cited for slow implementation were (1) unavailability of money or technology; (2) other management priorities; (3) lack of effective management skills to take action on audit findings; (4) a management view that the auditor's ideas are no good or impractical because the ideas did not come from the management team; (5) management's pride and concern over job security; (6) management's unwillingness to sacrifice a department goal for the good of the larger governmental unit; (7) management's view that performance audits are intrusions in its domain rather than a positive tool for change and a source of valuable information and (8) political motivations.

Political inaction was an issue addressed by several responding auditors. However, one auditor summarized the issue by pointing out that there is a gen-

managers who see any sort of audit criticism as dangerous to their (or associates') careers. The possibility of intense media scrutiny of actions seems to have created an automatic defensiveness against anything that might imply they are less than perfect in the execution of their duties and responsibilities.

With this type of environment, it is difficult for management to acknowledge the existence of problems noted by auditors. When the environment is such that the responsible individuals are subjected to pressure that might be personally jeopardizing to them, there is an automatic resistance to acknowledging and accepting that the problem exists. Therefore, the initial reaction from management is to refute the existence of the problem, which obviously will divert attention and energy away from seeking an effective solution. Couple this with the fact that more and more audit functions are independent and thus isolated from considerations that determine the extent of corrective action, if any. So these political and management functions may not be working together, but each doing what it can in its own realm.

In our system of government, action and change involve the molding of bureaucratic initiatives, political approval and public acceptance. Often the audit function proposes the bureaucratic initiative. Management and elected political officials can approve and proceed with the initiative (usually corrective action) or they can choose inaction. As a concept, political inaction may invoke a sinister connotation; however, such inaction certainly can run the gamut. For example, responding auditors cited forms of political inaction like (1) delays to planned corrective actions simply due to a change in administrations or (2) legislatures reacting to lobbying interests choosing not to make changes recommended by audit reports. When inaction on a sensitive issue is noted by the media, it is reported to the public. This is often portrayed as a scandal. If the public does not accept the inaction, pressure will often cause political action. Thus, the nature of the audit process may well involve an occasional scandal which develops when management misreads the political importance to the public.

Links among political (in)action, the public and the media were the subjects of several comments. The role of the media was portrayed from one end of the continuum to the other. Summarizing the myriad of views expressed, responding auditors saw the role of the media as that of (1) an attention getter or creator of more pain than an audit report can create; (2) an intermediary, making sure that parties able to create change are made aware of the need and/or (3) an alarmist, leaking information and creating a scandalous air before appropriate parties have time to address the issues and activate a plan for improvement.

Some responding auditors indicated that their policies do not include the official release of audit reports to the press. Rather, their audit work includes making the plan for effective change before the matters get to the press. Others expressed that journalists do not always offer a balanced presentation of the issues, nor do they necessarily report on corrective action. Nonetheless, press or media scandals were not viewed as necessarily bad since they tend to focus attention on issues.

Based on written comments, it appears that most auditors who had scandals develop in audited areas generally believe, that they have done a good job of identifying, analyzing, reporting, selling and following up on the audit findings. They also believe scandals could have been avoided or mitigated if management had done a better job or political inaction had not occurred. In that regard, responding auditors saw some value to media attention on an audited area which has been ignored by management or those with final authority.

Demographic Sheet Comments.

The second area of the survey package encouraging auditors to provide their views on relevant issues was found on the Demographic Information Sheet, which asked:

> *In your opinion, are there aspects of the audit process . . . which at times contribute to management's failure to use audit reports to mitigate the impact of scandalous publicity on an audited matter?*

Responding auditors' comments were diverse and numerous. However, the comments may be classified into the following areas of concern: (1) inadequate audit scope and independence, (2) finding development, (3) auditor relations, (3) follow-up systems, (4) reporting hierarchy, (5) recommendation development, (6) audit reports, (7) resources and (8) politics. These non-case-specific comments did not differ greatly from those discussed above, relating to specific performance audit cases.

Finding Summary

Our survey indicated that only 26 of the 3,788 performance audits performed by responding auditors in the last three years contained audit findings that were ignored, leading to media attention. Based on the responses received, it appears that the incidence of ignored audit findings resulting in media attention is not a widespread problem. However, when a scandal does occur, it usually has significant implications for the management and political officials involved. Therefore, it is important to identify reasons why findings are ignored and use this knowledge to design an approach to auditing and reporting that will increase management's acceptance of findings, ensuring corrective action is taken.

We analyzed responses submitted on case sheets for specific cases where findings were ignored and responses for cases where corrective action was taken by management. Our research identified several factors which may assist auditors in modifying their audit approach to improve acceptance of audit findings by management and timely corrective action.

First, we determined that auditors generally do not consider weaknesses in the audit process as a factor in audit findings being ignored by management. They believe that scandals primarily result from management's failure to take corrective action. This position is supported by our research, which failed to identify a significant relationship between the auditor's presentation of audit findings and whether or not findings are ignored. This evidence suggests that management's interest in the audit and understanding of any audit findings are the key determinates of whether or not the findings are ignored.

Second, our research identified a significant relationship between level of communication and subsequent correc-

tive action. Attributes on the survey responses identified the following factors which contribute to management addressing findings and initiating corrective action: (1) the level of management receiving the audit report, (2) when appropriate parties have access to audit findings and (3) the level of involvement by those officials responsible for initiating and ensuring corrective action.

In addition, case-specific comments received indicated that issues relating to communication have been factors in management not taking appropriate corrective action. Some auditors expressed concern that sufficient effort was not exerted to convince management of the value of audit recommendations. Others stated that management sometimes has difficulty understanding audit recommendations, especially when highly technical data is involved. Finally, some auditors stated that findings of lesser significance were included with major findings which diffused management's attention.

Based on the results of our research and survey responses received, we can conclude that many of the reasons audit findings are ignored relate to the level of communication between auditors and report users. Adequate communication is critical in ensuring that the findings are not ignored and that corrective action is taken. Communication between the auditor and auditee should continue throughout the planning, performing and reporting phases of an audit.

Recommendations

The task force presents the following recommendations to increase the acceptance of audit findings and thus improve the usefulness of performance audits. These recommendations are based on our findings and are in keeping with existing guidance provided by the AGA's "Task Force on Performance Auditing" report, the 1994 Yellow Book and the GAO publication "How to Get Action on Audit Recommendation." This literature suggests a need to sell audit findings, provide early and open dialogue on findings, produce reports that are clear, concise and have meaningful findings with workable recommendations, and develop a consistent follow-up system to assure corrective action is taken.

Based upon a combination of demographic and case study input, the task force recommends that each audit practitioner review the questions listed in Table 2. These questions are intended to identify conditions that may affect the usefulness of performance audits and the related risk of a potential scandal. With regard to the media, we urge the auditor to assess the short- and long term ramifications for the organization and the auditor that ultimately result from public attention to audit work. Such attention will likely create a change in management's approach to and attitude regarding audit reports. Assessment of appropriate courses of action regarding the release of audit reports requires due consideration of the nature, timing and extent of media coverage.

Conclusion

Overall, auditors believe that they address the real cause of the problems they uncover. However, this should not diminish the concern that a scandal could develop if certain conditions exist within an organization or program. No matter how isolated the incidence of scandal may be, both auditors and auditees should face the reality that potential risks and exposures may develop into scandals when specific conditions are present. Such conditions include political pressure, underlying corruption or management inaction present within an organization. As professionals, auditors must continue to focus on maintaining a high level of compliance with the audit standards and on the need for continuous vigilance.

Our combination of survey responses and accompanying comments suggests that there is a relationship between the level of communication with management and a positive response to audit recommendations. Thus, we urge auditors to establish a relationship with management that will facilitate communication. This increased level of communication should be used by auditors to identify user needs and expectations, focus audit objectives on satisfying those needs and to make specific recommendations. If auditors give users information about their programs that they can use while providing solid recommendations to correct problems, it will be more difficult to ignore the audit findings.

While our evidence suggests that there is not widespread occurrence of performance audit findings being ignored prior to scandals in government, auditors responding to our study have contributed valuable knowledge grounded in years of performance audit experience. Their understanding and perceptions of the performance audit environment, when evaluated in terms of existing audit literature, have allowed us to achieve our task force objectives and develop recommendations to help prevent audit findings from being ignored. We believe the primary contribution of this report is the insight it provides on the performance audit environment at all levels of government. We are grateful to all who have devoted their time and effort to our cause.

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TEXAS ASSOCIATION OF COUNTY AUDITORS
SEGREGATION OF DUTIES QUESTIONNAIRE

Auditee:			
Prepared by:	Date:	Updated by:	Date:
Updated by:	Date:	Updated by:	Date:
Updated by:	Date:	Updated by:	Date:

Place an "x" in the column of the person performing the duty or having responsibility		Person Performing Duty/Responsible								
Duty/Responsibility	Function Type	Not Done N/A								
1. Receives money	Custody									
2. Issues receipts	Custody									
3. Opens and lists mail reciepts	Custody									
4. Subsequently compares listed mail receipts to recorded cash receipts	Approve									
5. Balances receipt copies against cash drawer	Custody									
6. Verifies that voided original receipts are kept and reviewed	Approve									
7. Accounts for numerical sequence of cash receipts	Record									
8. Maintains cash drawer	Custody									
9. Prepares bank deposits	Custody									
10. Compares bank deposits receipts to bank stmt.	Approve									
11. Records rcpts in cash received journal/log	Record									
12. Access to inventory of unused cash receipts	Custody									
13. Maintains inventory log of unused cash receipts	Record									
14. Prepares reports of cash received	Record									
15. Responsible for collection of returned cks	Custody									
16. Prepares checks for cash disbursements	Custody									
17. Signs checks 2 signatures required? Yes _____ No _____	Approve									
18. Access to blank checks	Custody									
19. Takes inventory of and orders blank checks	Record									
20. Records disbursements in cash disburesments journal/log	Record									
21. Reconcile bank stmts	Record									
22. Reviews reconciled bank statements	Approve									
23. Posts to receivables	Record									
24. Prepares billings & follows up on delinquencies	Record									
25. Ability to write off any receivables/ dismiss cases	Record									
26. Authority to write off any receivables/ dismiss cases	Approve									
27. Review, approve & sign monthly fin reports	Approve									

AUDIT WORKORDER

AUDITEE:	AUDIT DATE: / /
AUDITOR IN-CHARGE	AUDIT TYPE:

COMMENTS:

AUDIT STEPS	TOTAL HOURS	DATE										

AUDIT REVIEW AND SIGNOFF				
STEPS	AUDITOR IN-CHARGE		SUPERVISOR	
	INITIALS	DATE	INITIALS	DATE
Preliminary draft of report written & ready for review with official				
Final audit report ready to be issued				
Audit is complete and ready for filing				

PERMANENT FILE INDEX

AUDITEE:			DATE CREATED: / /
INCLUDED	INDEX #	DESCRIPTION	
	10	Overview of Office	
	20	Personnel and Office Organization	
	29	Personnel and Office Organization - superseded	
	30	Contracts	
	39	Contracts - superseded	
	40	Statutory Items	
	41	Statutes - General	
	42	Fees Required by Statute	
	43	Fees Allowed at Discretion of County	
	49	Statutory Items - Superseded	
	50	Audit Programs	
	59	Audit Programs - Superseded	
	60	System Documentation	
	61	Documentation Guide - Internal Control Environment	
	62	Cash Flow Control Questionnaire	
	63	Narratives	
	64	Flowcharts	
	69	Systems Documentation - Superseded	
	70	Sample Forms	
	79	Sample Forms - Superseded	
	80	Audit Log	
	90	Audit Reports & Responses	
	91	Reportable Conditions Point Sheets	
	95	Audit Reports	
	98	Auditee's Responses	
	100	Other	

AUDIT LOG

AUDITEE:

TYPE OF AUDIT	DATE FIELDWORK BEGAN	DATE FIELDWORD COMPLETED	DATE REPORT COMPLETED	DATE REPORT RELEASED

CODES FOR TYPE OF AUDIT

LS - Limited Scope Audit
- a. Routine
- b. With Payroll Handout
- c. With Fixed Asset Observation

FS - Full Scope Audit

FSS - Full Scope Surprise Audit (required once per year by statute)

SR - Special Request

CURRENT FILE INDEX

AUDITEE:	AUDIT DATE: / /
AUDITOR IN-CHARGE:	AUDIT TYPE:

INCLUDED	INDEX #	DESCRIPTION
	1	Audit Work Order
	2	Audit Program
	3	Reportable Conditions Point Sheets
	4	Audit Report
	5	Wtitten Repsonse of Official
	10	Notes for Subsequent Audits
	20	Reports Generated by Auditee
	30	General Ledger Analysis
	40	Bank Reconciliations & Analysis
	50	Cash Counts
	60	Receipt Tests
	70	Disbursements Tests
	80	Confirmations
	90	Open Section
	100	Fixed Assets
	110	Payroll Handout

REPORTABLE CONDITIONS POINT SHEET

OFFICE _____ DATE _____

AUDITOR _____

CONDITION _____

_____

_____

_____

_____

REASON IMPROVEMENT NEEDED _____

_____

_____

_____

_____

RECOMMENDATION _____

_____

_____

_____

_____

FOR COMPLETION BY FIRST ASSISTANT COUNTY AUDITOR:

1. RECOMMENDATION DISCUSSED WITH OFFICIAL? ___ NO ___ YES DATE _____

   IF NO, WHY NOT? _____

_____

_____

2. FINDINGS LETTER ISSUED TO OFFICER? ___ NO ___ YES DATE ISSUED _____

   IF NO, WHY NOT? _____

_____

_____

3. FINDINGS LETTER COPIED TO COMM COURT ___ NO ___ YES DATE ISSUED _____

OFFICIAL'S RESPONSE _____

_____

_____

PROOF OF CASH

ACCOUNT NAME: _____

AUDITEE:	
AUDITOR:	AUDIT DATE:

DESCRIPTION	BEGINNING OF MONTH	ADDITIONS	REDUCTIONS	END OF MONTH
PER BANK STATEMENT				
DEPOSITS IN TRANSIT, BEGINNING (1)	+	-		
DEPOSITS IN TRANSIT, END (1)		+		+
OUTSTANDING CHECKS, BEG. (1)	-		-	
OUTSTANDING CHECKS, END (1)			+	-
OTHER RECONCILING ITEMS				
PER BOOKS				

COMMENTS:

(1) ATTACH DETAILED LIST

CASH COUNT

AUDITEE:	
AUDITOR:	COUNT DATE:
CASH CUSTODIAN:	
DESCRIPTION OF CASH COUNTED:	

CASH AND CURRENCY

DENOMINATION	AMOUNT
.01	
.05	
.10	
.25	
.50	
1.00	
5.00	
10.00	
20.00	
50.00	
100.00	
TOTAL	

CASH FUND RECAP

CASH AND CURRENCY	
CHECKS & MONEY ORDERS	(A)
TOTAL MONIES ON HAND	
LESS CASH CHANGE FUND	
MONIES COUNTED, EXCLUSIVE OF CHANGE FUND	
TOTAL OF RECEIPTS ISSUED SINCE LAST DEPOSIT	(B)
CASH OVER (SHORT)	

THE ABOVE CASH WAS COUNTED IN MY PRESENCE, AND WAS RETURNED TO ME INTACT

BY _____

RECEIPTS TO ACCOUNT FOR

BEGINNING RCPT. NO.	ENDING RCPT. NO.	BATCH TOTAL	MANUAL OR COMPUTER GENERATED
			☐ MANUAL ☐ COMPUTER
			☐ MANUAL ☐ COMPUTER
			☐ MANUAL ☐ COMPUTER
	TOTAL (B)		

CHECKS / MONEY ORDERS

SOURCE	AMOUNT	SOURCE	AMOUNT
		TOTAL (A)	

IF ADDITIONAL SPACE IS NEEDED, CONTINUE LISTING ON SEPARATE PAGE. JUST RUN ADDING MACHINE TAPE IF > 30 CHECKS

AUDIT SAMPLE SELECTION DOCUMENT

AUDITEE	
AUDITOR	

AUDIT DATE	

OBJECTIVES

POPULATION

DESCRIPTION: _____

NUMBERED DOCUMENTS ? ☐ YES ☐ NO

IF YES, RANGE OF NUMBERS : FROM _____ TO _____

DATES COVERED : FROM _____ TO _____

IS POPULATION HOMOGENEOUS ? ☐ YES ☐ NO

IF NO, DESCRIBE RANGE OF DIVERSITY: _____

_____

SEQUENTIAL SELECTION

NUMBER OF ITEMS IN POPULATION: _____ SAMPLE SIZE: _____

STARTING POINTS: FIRST _____ SECOND _____ THIRD _____

Nth ITEM DETERMINATION:

Number of Starting Points	X	Population Size	/	Number of Starts		Nth ITEM INTERVAL
					EQUALS	

NOTE: If it becomes necessary to increase the sample size due to discrepancies in the first sample, continue using the same Nth item, but start from a fourth, fifth & sixth set of starting points until larger sample size is obtained.

INCREASE IN SAMPLE SIZE: _____

ADDITIONAL STARTING POINTS: FOURTH _____ FIFTH _____ SIXTH _____

BLOCK SELECTION

NUMBER OF ITEMS IN POPULATION: _____ NUMBER OF BLOCKS: _____

NUMBER OF STARTING POINTS: _____ NUMBER OF ITEMS PER BLOCK: _____

STARTING POINTS: FIRST _____ SECOND _____ THIRD _____ FOURTH _____

NOTE: If it becomes necessary to increase the sample size due to discrepancies in the first sample, and only three blocks were selected originally, select a fourth block, now.

STARTING POINT OF FOURTH BLOCK DUE TO DISCREPANCIES: _____

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
FRAUD HAPPENS: A PRIMER ON LYING, CHEATING AND STEALING

The article presented in Appendix 10.2 was publised in the December, 1995 issue of Government Finance Review, and was written by Mr. Arthur A. Hayes, Jr., J.D., M.B.A., CPA. Mr. Hayes is director of the Division of State Audit in the State of Tennessee. The article is copyrighted and Mr. Hayes has graciously consented to its inclusion in the Texas Association of County Auditors' Audit Guide.

Fraud Happens: A Primer on Lying, Cheating, and Stealing©

Pointers to help educate managers about the real risks in the organization and how to detect fraud.

By Arthur A. Hayes, Jr.

During many conversations with auditors and in training programs, the author has come to believe that the "practice" of public accountancy, particularly relative to auditing, is grounded on experience. Education and training are essential to a mastery of the basic concepts of the profession, but seasoned judgment is based on experience. Yet, auditors are not gaining [illegible]h real life, first-hand experience in [illegible]uiting for fraud. The author's informal survey of participants at presentations and courses on fraud indicates that less than 5 percent acknowledge ever having conducted a fraud audit or otherwise having had experience with fraud.

This article draws on the author's long experience in auditing and teaching to capture a few of his basic concepts about fraud. It is not an exhaustive treatise on the subject, but it may give the reader a new perspective on fraud and a practical frame of reference for detecting fraud. These concepts are presented to give the auditor every advantage possible in the battle against fraud and the persons who perpetrate it.

How Does Fraud Happen?

Many frauds begin as honest mistakes—nothing more, nothing less. What happens when an employee makes a mistake and does not get caught? A brand new employee, for example, is assigned the responsibility of making daily deposits. The employee makes the deposit for the first few days with no problems, then one day [illegible]ets to do it. After waking up in a cold sweat in the middle of the night, the employee races into the office the next morning to find the bank bag. It is all still there. Feeling unsteady about the matter, the employee goes to the boss and confesses. What is the boss' reaction? "That's okay, don't worry about it."

The situation reveals a slackness in the system, an indifference to good controls, an opportunity. Maybe at first the employee might just hold some of the deposits for a while to see how the system reacts, not spending the money so as to be able to turn it in as an oversight if caught. Eventually, and it will not take very long, the employee gets tired of just practicing and starts keeping some of the money, realizing that things are such a mess that it probably will be possible to stall any questions long enough to cover the theft. The above scenario is generally true—fraud happens.

To be able to detect fraud, one must have insight into the actions and the techniques of the fraudster. It does not take a genius to steal. Most of the fraudulent situations that the author has investigated were relatively easy-to-understand and easy-to-perpetrate schemes. There are three types of people in the world.

- Those who would not steal anything. One could leave $1,000 on a table, unattended, and if these people came across the money, they would not only not steal it but would be so terrified that this money was just lying there that they would rush out to find someone in authority to take charge of the money. This group is extremely small and getting smaller. Such persons can be thought of as "corruption impaired."
- Those who will steal if the circumstances are right. Such people, coming across the $1,000 would count the money, look around and assess the risk of being stopped with the money or being seen leaving the room, considering whether the location is a place where they are known, or whether, if stopped on the way out, it would be possible to say they were on the way to turn it in. The most important question these people would have is "Who's money is this? If it is public funds, who is going to get personally upset about the theft of public funds? No one." The greater the amount of money, the more risk these people may be willing to take. This is a large category of persons often called "opportunists."
- Predators. These persons are at the other extreme of the continuum: they may have started as opportunists, but then they could not stop. When they are found stealing, these people frequently are found to have a long history of stealing. The author calls these people "gifted."

Fraud happens because almost anyone can move to the opportunist level. Internal, personal factors, such as an acute need of money—due perhaps to sickness or other unfortunate circumstances or personal problems, such as dysfunctional relationships or addictions—combine with situational factors—unguarded money, for example—to grease the skids for them.

Under the right circumstances, anyone can become gifted. And, as personal needs become greater, perpetrators will be motivated to overcome greater and greater hurdles in their quest for payday. Even if the organization has a fairly well-designed internal control structure, the truly motivated criminal will find ways to attack it.

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Exhibit 1
PRETEST FOR FRAUD POTENTIAL

T	F		
☐	☐	1)	I have never told a lie.
☐	☐	2)	I have sometimes made statements which were not technically correct but only if there was a good reason.
☐	☐	3)	I have never stolen anything.
☐	☐	4)	I have taken things that were not technically mine but only if I had a moral or ethical claim to them.
☐	☐	5)	I think that most people are gullible.
☐	☐	6)	You are selling your home. You have had some serious water damage in one wall, but a nice coat of paint covers it up. You would be sure to call attention to the underlying problem whenever a prospective buyer came to look at the house. (Can you say "Caveat Emptor?" Or "Look out sucker, don't be a fool!")
☐	☐	7)	I often feel overworked and underpaid.
☐	☐	8)	My co-workers do not know how smart and clever I really am.
☐	☐	9)	I believe that failure to manage my personal finances demonstrates a serious character flaw; one which I would never want to disclose.
☐	☐	10)	I am tired of having to tell my family "no" every time they want to buy something.
☐	☐	11)	I believe that people who play strictly by the rules are naive.
☐	☐	12)	I believe that most really successful people have broken the rules to get ahead.

Note: The author does not provide the "correct" answers; however, he offers readers the following insight for analyzing their score: Many times psychological tests will include certain questions which do not seek to directly measure the personality traits of the individual but rather attempt to assess his or her proclivity to tell the truth. The questions in mind are those which obviously should be answered one way, based on human experience, but due to the nature of the question and the sensitivity of the person being tested, they lie on the question. Truth is no fun.

The author frequently invites participants in fraud seminars to take the true or false self-administered test shown in Exhibit 1, the Pretest for Fraud Potential. He interprets a score of more than seven trues to indicate that the test taker is probably approaching the gifted category. This test was developed after many years of studying frauders, particularly talking with them after they had admitted their actions. The point is, frauders are people just like any others encountered in a government office or private enterprise.

Disincentives for Finding Fraud

Auditors do not adequately detect fraud. Most people, whether auditors or not, desire not to be required personally to find fraud because they are uncomfortable accusing someone of dishonesty. They prefer to depersonalize matters: It is easier to talk about "weak internal controls: management can improve these things." Things do not steal, however; people do.

There are many disincentives to finding fraud. Auditors do a good job of finding noncompliance with laws, rules, policies, and procedures, as well as internal control structure reportable conditions and material weaknesses. But that is where they stop; they do not push things to the next level. They do not want to offend anyone. The two weakest links in the audit process relative to fraud detection are interviews and the skeptical assessment of circumstantial evidence.

Auditing is not easy, and it is becoming more difficult. With ever-expanding standards to follow and increasing levels of litigation or disciplinary actions against auditors, the risk of "audit failures" has prompted many certified public accountants (CPAs) to move away from auditing into safer consulting practices.

Before accepting the next audit engagement, especially in the public sector, an auditor should ask, "Do I really want to find fraud?" If one does not want to find fraud, it will not be found. And the auditor will not be meeting the expectations of many citizens—the "little people." That should matter to any auditor, if for no other reason than the possibility that one of those little people may someday have another title—juror.

Management and Fraud Detection

It is important that managers of entities administering government or public programs understand the dynamics of audits and the expectations of the principal parties. Auditors spend only a limited amount of time at the entity. They only look at a sample of the numerous transactions of the entity for the period under audit. Yet, in that very small amount of time, the auditors are expected to find all of the problems that have gone undetected by management of the entity. That is, auditors should know more about the operations of the entity than those persons responsible for the day-to-day operations of the entity. Auditors must be the brightest people in the world.

It is widely acknowledged that it is the responsibility of management, not the auditors, to insure that the organization's books and records accurately reflect operations of the entity and that the entity's assets are properly safeguarded from theft or abuse. Yet, when the audit commences, there is the pervasive feeling that it is like a deep-space probe to an uncharted part of the universe: who knows what they will find?

A look at how and why fraud happens may serve to educate management about the real risks in their organization and permit them to be a bit more skeptical when they see weird things happening in their entity. In all the examples here, managers were convinced that all was well with their systems. Although auditors may grow relaxed about fraud, the attitude of

management is not so easygoing: if there is a problem in the organization, managers have failed, and they have been "betrayed" by their trusted employees.

A Word About Lies. Fraud involves misrepresentations or distortions of the truth that can take the form of concealment or falsification. Concealment, being passive, is the preferred approach. But some frauds, such as those involving the submission of documents which trigger payments, require falsification practically from the outset. There is a third approach to lying, which is somewhere between concealment and falsification: the faulty memory.

Whatever approach a frauder employs in his or her lies, one thing is certain: the liar who picks a victim who wants to believe the lie will be more successful than someone whose victim is skeptical. Who wants to believe lies? Everyone, especially management and auditors. With regard to management, it is natural to believe the people with whom one works and upon whom one relies for information and operations every day. Managers like the folks they work with and believe themselves to be a good judge of character.

Auditors are paid to be skeptical. But auditors get to know the people whom they audit and establish rapport with them, and auditors have a reputation to consider: what would it say about an auditor's exercise of due professional care if he/she learned or admitted that auditees had been defrauding the entity for years during that auditor's prior engagements?

Both management and auditors should not be a willing target of lies.

The Auditor's Role

Exactly what is it that auditors do? What should they be doing? The answer depends on one's perspective and on the nature and terms of the engagement. To many people—including legislators, judges, and juries—the primary benefit gained from an audit is a determination of whether fraud has occurred. Auditors generally are viewed as the watchdogs for the rest of the public who do not have the time, money, standing, or expertise to delve into the entity to see what is really going on. This sentiment is particularly true with regard to public funds or institutions.

One of the ironies of government is that the one hand government is so open, yet at the same time it can be closed to the average citizen. Even if one were to gain unlimited access to government files, the mere volume of files and documentation would make meaningful analysis of the data very difficult. Furthermore, it is generally believed that confidence in public officials and institutions currently is at an all-time low. It is into this cauldron that the auditor of public funds and agencies is thrust.

Government audits clearly are different from audits of the private sector. The government/not-for-profit sector is where most of the programs wanted by the citizens are carried out. The activities of these agencies are highly structured, or at least the programs they administer are replete with many rules governing who is to receive the benefit (or penalty) and what that benefit (or penalty) will be.

A government audit engagement typically consists of three types of audits involving three levels of auditing standards—*Generally Accepted Auditing Standards*, *Governmental Accounting Standards*, and *OMB Circular A-133*.

- Traditional financial statement audits comply with *Generally Accepted Auditing Standards* (GAAS). These standards are primarily derived from the American Institute of Certified Public Accountants (AICPA) Statements on Auditing Standards. At present there are 74 of those standards, commonly referred to as SASs.
- Additional requirements for audits of governmental entities or programs are promulgated by the U.S. General Accounting Office (GAO). Those standards, referred to as *Generally Accepted Government Auditing Standards* or GAGAS are printed in a book referred to as the "Yellow Book," due to the color of its cover. The most recent revision of the Yellow Book is the 1994 edition. The Yellow Book provides in its introduction that the GAGAS are applicable to audits of federal organizations, departments, agencies, programs, activities, and functions. The Yellow Book also points out that the Single Audit Act of 1984 requires that GAGAS be followed in the audits of state and local governments which receive federal financial assistance. In addition, other federal policies and regulations, such as *OMB Circular A-133* (The Single Audit) require that GAGAS be followed in audits of higher education institutions and other nonprofit organizations receiving federal funding. Finally, the audit contract or agreement may require a GAGAS audit.
- Single audits are the third level of audits for governments. Single audits are entitywide audits performed in accordance with the Single Audit Act of 1984, a federal statute, or the U.S. Office of Management and Budget's (OMB) *Circular A-128* or *Circular A-133*. Although single audits are primarily concerned with the audit of federal financial assistance received by an organization, states and other nonfederal grantors may impose the requirements of the single audit on their subrecipients.

The responsibility for determining which type of audit is required in any particular situation is shared by the auditor and the auditee.

An underlying concept for this article is that the traditional audit is the principal vehicle for detecting fraud. This concept is founded on two basic tenets. First, as a practical matter, auditors are uniquely positioned to detect fraud. They already are inserted into the organization, should have access to all of the records of the entity, and the public is depending on the auditor to provide an independent assessment of the auditee. Second, the auditing standards require the auditor to address the probability, not just the possibility, that fraud has occurred. The standards, in response to public disenchantment with the performance of auditors, have increased the auditor's responsibilities relative to fraud beyond the need to be alert to the possibility of fraud to designing the audit to give reasonable assurance of detecting material errors or irregularities.

Public disenchantment with audits has been referred to as the "expectation gap;" that is, the gap between what the public believes auditors are responsible for and what auditors believe they are responsible for. This disenchantment had been most clearly demonstrated in litigation directed at CPAs by third parties adversely affected by the audited entity who seek to hold the auditor liable for failing to identify problems with the auditee.

The different perspectives of the various parties involved in the process of auditing make auditing a difficult task. Third parties relying on the audit frequently feel that the auditor should do more work, but there is a cost associated with the extent of the work performed, and that cost is usually borne by the auditee who is less interested in an as in-depth audit as are the third parties.

Few if any other professions measure success by getting their clients into trouble.

Exhibit 2
CONCEPTS AND FRAMEWORK FOR DETECTING FRAUD

1) Given enough time, anyone can steal anything. Many key control procedures are designed to process transactions as quickly as possible. For example, daily deposits are preferable to weekly deposits. If cashiers have seven days to make a deposit, they can "use" the money for several days before they have to turn it in. This is the classic case of "borrowing" the money they receive. If seven days is the acceptable period for making deposits, such borrowing is invisible because seven days gives the thief ample time to borrow the money received from one person and replace it with receipts from a subsequent client. When faced with a daily depositing requirement, the frauder may be forced to *de facto* "amend" the policy and extend the period for deposits. The auditor should be particularly sensitive to signs that someone is "stretching the time envelope." It is called a clue.
2) The key to detecting fraud is the way the auditor reacts to "bad signs," such as those suggesting the theft of time. Are "bad sounds" heard as excuses overlooked? For example, when a supervisor asked a clerk at a decentralized collection point why she had recorded absolutely no receipts of a particular type for more than two years, she replied that she had miscoded them. This simple response bought her two more years and more than $25,000..
3) Frauders are frequently difficult to identify because they conceal their dishonesty behind a disguise of altruism and a false show of concern for others. The auditor cannot presume that anyone is incapable of committing fraud. For example, "special handled transactions" which circumvent the control structure may be justified as "going the extra mile" to help a "client" who is really in need. In reality, there is no client and very little documentation in the file, but no one bothers to ask any questions or to pry into the matter. "It would be in poor taste."
4) The internal control structure cannot be relied on to adequately constrain top management. Management override of the structure will occur. Top management does not mean the chief executive or chief financial officer. In settings featuring highly compartmentalized environments, top management is everyone who is in a position to act independently with minimal oversight.
5) Most frauds begin as accidents in which the frauder discovers holes in the internal control structure. Most schemes are relatively simple—like a clerk writing his/her name in as the payee after the boss signed a blank check.
6) The greatest advantage of the frauders is that they are highly motivated to commit the fraud and will persist in efforts to steal. They will not easily admit their actions, and they will steal more and more as time goes on.
7) Another significant advantage of a frauder is the tendency of many auditors and managers to outsmart themselves. When hypothetical cases are presented illustrating how someone stole in a particular setting, many auditors and managers will say, "How stupid. That would never work." Many simple schemes do work, at least for a while. People do stupid things every day.
8) The greatest disadvantage of frauders is that they do not know what the auditor knows or suspects; it is critical that the auditor keep this in mind during the audit and be careful not to inappropriately disclose critical information prematurely to the auditee.
9) The detection of indicators of fraud is just the first step in fraud detection. Interviews are essential, and any conversation with an agenda is an interview. Auditors must be aware of when an interview is being conducted. Frequently the auditors are the interviewee. If the danger to the auditor in this scenario is not clear, please see #7 above.
10) The greatest disadvantage of auditors is the attitude that they do not want to find fraud. Such an attitude tends to encourage auditors to stop their consideration of the possibility of fraud at the point of initial detection of the indicators of fraud; auditors avoid interviewing the frauder about those indicators or tend to accept any explanation just to get past the problem.
11) Professional judgment, especially relative to legal liabilities for either overlooking fraud or defaming persons accused of committing fraud, will be measured by what actions would have been reasonable under the circumstances.
12) One of the greatest internal control practices management can utilize is regular and thorough follow-up or oversight of employee functions which otherwise may become invisible through delegation. Compartmentalization and management concepts such as total quality management and other concepts which deemphasize controls in favor of empowerment of employees can create tremendous opportunities for fraud.

But this is part of the difficulty of being an auditor.

Practical Guidance

A practical framework for addressing the challenges of detecting fraud is presented in Exhibit 2. These concepts may be applied to certain specific types of transactions and activities within the context of relevant auditing standards and other guidance. In this way, the auditor of governmental programs and entities and not-for-profit organizations delivering governmental programs will be better able to meet his or her obligations relative to detecting fraud or abuse.

The principal role of auditors is to report. It is important that they not lose sight of their primary focus on auditing, for it is all too easy for auditors to initiate decisions and actions that are not their responsibility. The decision about prosecution is in the purview of the officials having the authority to prosecute: District Attorneys General or United States Attorneys General, who will be concerned that the auditor be able to prove that fraud exists in a program or agency to their satisfaction. Auditors may be disappointed in the decisions of these authorities not to pursue a case which they feel is air tight, but they should not be discouraged; their efforts are essential to the protection of public assets. Audit findings can serve to stimulate public awareness of serious shortcomings in the administration of programs, and their recommendations are key steps in improving controls to prevent future problems. And even if there is not a prosecution, the auditors' efforts may serve to deter individuals otherwise tempted to abuse their trust or may be sufficient evidence for noncriminal disciplinary action against the subject.

Conclusions and Caveats

Until the auditor considers the true opportunities for fraud in a particular situation, acquires a deeper understanding of the way in which fraud is perpetrated by normal people, and develops a better appreciation of the telltale signs of persons perpetrating fraud, it will be difficult to go beyond identifying weaknesses in the internal control structure and noncompliance with laws, rules, regulations, policies and contracts.

Recognizing the "themes" that frauders may use to perpetrate their thefts and to rationalize their behavior gives the auditor the opportunity to understand the signs discovered during the audit and to attack the frauder's explanations for those unusual bits of evidence.

The key concepts and advice of this article can be summarized in the following points.

1) Auditors and management share a responsibility to detect fraud; management has the duty to seek to prevent it.
2) The audit and management team can win. Thieves typically are not very bright, and they make many mistakes. They feel guilt at some level, and these tensions may result in odd behavior.
3) For auditors, including performance auditors, the traditional audit is the key tool in fraud detection, and every GAAG or GAGAS audit is a fraud audit.
4) The true meaning of "professional skepticism" must be understood and embraced. When presented with an excuse or explanation for an unusual transaction or process, consider the statement with skepticism: "You expect me to believe that?" or perhaps more to the point, "If I give this excuse to my bosses as I am discussing the matter, will they think I was a fool to buy it?"
5) Deemphasize the word "material" when it comes to indicators of fraud. Be professionally honest with the results of sampling. The number of items questioned may not be statistically significant, but perhaps a few more questions should be asked about it.
6) Audit management must set a tone that fraud detection is a priority and must not stifle creativity. It should be supportive of staff efforts to expend a reasonable amount of time exploring information relative to "risky situations." There also should be ample opportunities for staff to promptly discuss such situations with other staff and supervisors so that the issue is subjected to a seasoned review as early as possible.
7) Communications among staff regarding fraud that has been detected are essential. When a fraud perpetrated in a particular manner is discovered, work programs need to be reviewed to see what adjustments will allow future detection. Learn from fraud experiences.
8) Include courses in fraud detection in continuing professional education offerings, making sure that field auditors as well as audit management attend the courses. Auditee management at all levels also should attend classes to learn how vulnerable their systems may be to errors and irregularities and to better recognize the risky environments in their own offices.
9) Auditee management should set the tone for fraud prevention. They should develop a clear, written code of ethical conduct, establish an ethics officer, and should become acquainted with relevant professional literature. In particular, they might wish to read *Statements on Auditing Standards* (SAS) numbers 47, 53, 54, and 55. SAS 55, which discusses the internal control structure, currently is being amended to incorporate components of the internal control structure identified by the Committee of Sponsoring Organizations. Among these components is the responsibility of management to have in place a system for ongoing self-monitoring of the control structure with appropriate, timely corrective action being taken when necessary. The message is, "Don't wait around on the auditors."
10) Audit management also should establish appropriate written policies and procedures for staff to follow when they discover indications of fraud. This should include reporting responsibilities within the audit organization, coordination with other internal staff such as attorneys, as well as reporting to and coordinating with outside authorities such as prosecutors. Establishing such procedures will assist the auditor in making consistent, appropriate decisions in such situations. It also will serve to "demystify" fraud. If the position of management is not made clear to staff, they will be operating without all of the information and knowledge they need to succeed. And if staff do not succeed, the organization will not succeed. □

ARTHUR A. HAYES, JR., J.D., M.B.A., C.P.A., is Director, Division of State Audit, State of Tennessee and a member of the GFOA Executive Board. The copyright for this article is held by the author; for permission to reprint, please contact him at the Office of the State Comptroller, Nashville, Tennessee (phone: 615/741-1910; fax: 615/532-2765).

An Elected Official's Guide to INTERNAL CONTROLS AND FRAUD PREVENTION

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APPENDIX 10.3 WILL BE ADDED IN A FUTURE EDITION OF THIS GUIDE

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AUDIT GUIDE
A PRIMER ON CHECKS AND BALANCES

APPENDIX 10.5 is comprised of excerpts from the December, 1988 edition of City and County Financial Management Systems, published by the Texas Comptroller of Public Accounts. It contains an excellent discussion of internal control and segregation of duties questionnaires.

CITY & COUNTY
FINANCIAL MANAGEMENT SYSTEMS

BOB BULLOCK, TEXAS COMPTROLLER OF PUBLIC ACCOUNTS 111 EAST 17th St., AUSTIN, TEXAS 78774 DECEMBER 1988 #16

Is Internal Control Really Just "Red Tape"?

A Primer on Checks And Balances

We've all heard the story about the three biggest lies. Here's Comptroller Bob Bullock's own version: "The check is in the mail"; "I'm the tax man, I'm here to help you"; and, "Internal control is good for you."

"Except that in our case they're not lies at all," says the Texas tax chief. "If one of my folks says your sales tax check is in the mail, well, it darn sure is. And, even though my office has to collect and enforce taxes, I think we've done as much or more to help taxpayers and local governments as we've done to collect every penny rightfully due to us.

"Finally, I *know* internal control is good for you, because that's what makes it possible for me to say, 'I *know* your check is in the mail.' I *know* that good checks and balances are necessary to properly collect taxes—and to allocate your local shares correctly and timely."

Good internal control protects the innocent person who is trying to do the job right the first time.

Not Red Tape

The state's top fiscal officer stresses that internal controls are not just "red tape."

"A reasonable amount of procedures and paperwork are essential for any organization," said Bullock. "You get red tape when there's more paper and procedures than you need to get the job done, and when it costs more to control the procedure than it does to do it."

Bullock also emphasized that sensible internal controls help get the job done right the first time. Good checks and balances help the conscientious employee do the work, he said. "And if you're talking about fraud—well, those 'bothersome' checks and balances protect the person who is innocent and doing things right."

Cheap Protection

And for elected officials, the Comptroller has a special

Continued on page 2

INSIDE...

- The Why and How of Checks and Balances
- Special Internal Control Note For Tax Assessor-Collectors
- Center Section:
  - Internal Control Checklist
  - Checks and Balances Self-Quiz
- Division of Duties Worksheet

A lot of Texans are starting to feel more confident that the state is on the road to economic recovery.

They are spending dollars again.

When times are tough, folks and governments try to cut out the frills and spend their hard-earned dollars only on essentials.

Now Texans are once again spending those dollars on items other than food, housing, and clothing.

And cities and counties with a sales tax are beginning to notice the difference.

The cities' share of state sales tax revenue in recent months has been anywhere from 12% to 23.5% higher then the same months a year ago. And taking all of 1988 to date, there's a solid 12.5% increase over 1987.

This means that the counties that are sharing in the sales tax for the first time are also getting more than they thought.

We know that most of this increase is due to real growth in the economy–we figure the expanded tax base resulted in just a 3.5% increase city sales tax revenues.

And our forecasters think sales tax revenues statewide will climb at an average rate of more than 8% per year through 1991.

This is good news to those of you who have to juggle available revenues with increasing demands for services to balance your city and county budgets.

Bob Bullock
Comptroller of Public Accounts

Checks and Balances, *Continued from page 1*

piece of advice: *"A good system of internal control protects you."*

Bullock explained that, by law, many local officeholders are personally liable for the money that their office handles, so good internal control is obviously very important.

Others can be found personally liable if they can be shown to have been negligent—and being negligent can include failing to set up adequate checks and balances.

Also, every officeholder, and most non-elected department heads, are interested in good public relations—and good public relations does not consist of having an embezzlement, major error, or other mismanagement happen!

"The bottom line," said Bullock—who himself has to maintain tight controls over more than $11 billion each year—"Is that the person at the top is responsible for seeing that a good, reasonable system of checks and balances is in place and working. It's simply part of the public trust—it's your job."

Suffers from Neglect

The Comptroller's Local Government Program staff recently discussed their many years of firsthand experiences with internal controls in Texas cities and counties.

"On the whole, there really isn't enough emphasis placed on a proper system of checks and balances," said

See Back Issues, Watch Future Issues

More Internal Control In Other Issues

Previous issues of this newsletter have already covered several areas of checks and balances.

- Depository Contracts–December 1986 #9
- Budgeting–March 1987 #10
- Purchasing–May 1987 #11
- Cash Management–August 1987 #12

You'll want to refer to these issues for detailed coverage of these important areas. And watch for detailed coverage of checks and balances in other critical areas, too. Future issues will cover fixed assets, auditing your own office, accounting and reporting, and others.

the group's manager, Tom Nilsen. "We've seen the results of this neglect, and we read about it every day in the newspapers—missing money, sloppy management."

Rene Henry agreed: "There's too much reliance on doing things in whatever way they happen to work out—there's not enough thought put into internal control. The result is that one or two people in an office wind up doing most of the important work, and you've lost the checks and balances."

"And we're not talking about just fraud, either," added Jim Edwards. "Too often, people think of internal control only in relation to embezzlement, or other stealing. But it's just as important to prevent and catch errors. In fact, errors probably cause more problems, lost time, and misplaced money than fraud does."

Justine Young pointed to a case where a series of accounting errors over a seven-year period contributed to a cash shortage of $115,000 in a local government. "This is just inexcusable," she said. "To not catch the error in the first place is bad enough. But to let it go on undetected for several years means that there was a very serious neglect of the most basic checks and balances."

The Local Government staff said that many people just don't appreciate how good procedures can help an office run smoothly. Or, they think that just because nothing bad has happened in their office, that everything is OK.

"But, it too often turns out that the real reason that there's been no major errors or fraud is only that they haven't been discovered—until it's too late."

The staff pointed out that uncovering occasional errors or fraud in their early stages is actually evidence that internal control checks and balances are working.

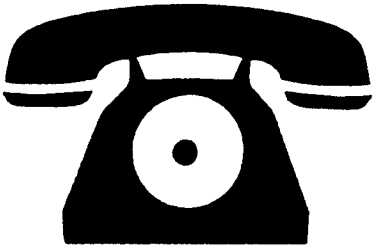
"The real problem is one of education. Once people find out about the benefits of good internal control, and that it's really not all that difficult to do, they want to apply it their office. Many times, all they need is some help in setting up a system for their particular office."

Bullock said that a major purpose of the Comptroller's Local Government Program is to provide just such help. "This issue of *City and County Financial Management Systems* gives you the basics. When you're ready to see what could be done in your office, just give us a call. We'll discuss your particular situation with you. We can even set up a workshop right in your city hall or courthouse."

The Comptroller noted that the state, too, benefits from good internal control in counties and cities: "Better checks and balances in your offices means that the monies you collect for the state are handled more accurately and timely. It's a win-win situation all around."

The number to call is toll-free: 1-800-531-5441, extension 3-4679.

Questions?
Call the Local Government Group
Toll Free
1-800-531-5441
Extension 3-4679



Here's the Why and How Of Checks and Balances

Read these articles and the questionnaire on page 9—and then test yourself on what you should have learned! (Test begins on page14.)

1. *What is meant by "checks and balances"? How are they different from "internal control"?*

There isn't any real difference. Internal control is a system of checks and balances. They are the organization and procedures in your office, and in your city or county as a whole, that help get the job done right the first time. They include procedures to:

- safeguard assets (money, data, equipment, etc.—anything of value)
- prevent errors
- check accuracy and reliability of information in journals, ledgers. dockets, and other records
- encourage adherence to policies and procedures
- encourage adherence to laws and regulations.
- promote efficiency and effectiveness.

If your office has good checks and balances—has good internal control—you will have a minimum of errors and little chance of fraud—and what errors and fraud you may have will probably be caught very early, before they have a chance to become major. And, you and your staff will virtually always act in accordance with state and local laws, regulations, and policies.

Complete the Questionnaire on Page 8 and the Self-Quiz on Page 14

2. *So, if I do what you tell me to in this article, I won't have any problems with mistakes, embezzlement, and all those state and local rules?*

Well, *almost* no problems. Sorry, but no system of checks and balances is 100% foolproof. Even if you had enough people so that one person was doing nothing but checking on one other person, those two could still collude in some kind of scheme.

If there was a foolproof system, it would cost so much it wouldn't be worth it.

The point is to *minimize* chances for errors and fraud, and to catch early those errors and frauds that do happen. Fortunately, the things you can do to minimize the chances for errors and fraud are very simple and very cheap.

The problem is that too few people do them!

There's proof enough of this in the stories you have heard, and in the newspapers almost every day.

3. *So what are the basic principles of a good system of checks and balances?*

There are just four very basic and very straightforward ideas that you need to apply to your office to get good internal control:

(1) Divided duties.
(2) Qualified personnel.
(3) Sound procedures
(4) Sound performance.

We'll discuss them individually. They're mostly a matter of common sense.

4. *What does divided duties mean?*

It simply means that no one person handles related transactions or events from

beginning to end.

Let's take the example of an office that collects money.

In that office, no one person should do all of the following:

- collect money from the public.
- make up the bank deposit.
- approve the bank deposit.
- make cash entries to the journals and ledgers.
- make entries to taxpayer accounts, dockets, case files.
- reconcile the bank statements.
- make up the monthly report.

One person is simply doing too much. Other people need to be involved—in fact, at least three, and preferably four people are needed for a really good division of duties.

Why? Think about it. In the above example:

- If an error is made, there is no check or balance to catch it—it can travel all the way through the system, from collection to bank to books to reports, because there is no one else to check the data.
- Fraud is much easier to commit, because the same person that pockets cash can cover it up by making compensating entries to bank deposit slips, journals and ledgers, dockets, case files, taxpayer accounts, bank reconciliations, and even monthly reports. There is no other person involved to catch the falsified records, or to question data that may be inconsistent.

At least three, and preferably four people are needed for a really good division of duties.

Even if no one of your clerks is involved in all of these activities, what about your supervisors? Does one of them have authority in all these areas?

If so, it's time to re-allocate supervisory duties.

Remember, people often do not catch their own mistakes. And the most valued, longtime trustworthy employee—the one who is so good that you've given all these duties to her or him—is usually the one who knows how, and has the opportunity, to beat the system and get away with it.

This is not a matter of setting up an atmosphere of mistrust in your office. It is a matter of establishing an efficient, smoothly running system of procedures that helps people get their jobs done right.

People often don't like internal control checks and balances—"red tape"—but they're there to help and protect the innocent person who is trying to get the job done *right*.

5. How could a fraud happen if duties are not properly divided?

Here are two very common examples.

In *lapping*, an employee has access to both cash receipts and accounts receivable, such as property taxes or fines.

Cash receipts are pocketed, from the mail or over-the-counter collections. The taxpayer's accounts receivable is not credited.

Then, the cash shortage is covered up by using the cash from a subsequent payment. The first taxpayer's accounts receivable is then credited, but not the second's. This new shortage is made up by using a third payment to cover the second shortage, and crediting the second taxpayer's accounts receivable—and so on.

In *kiting*, an employee makes out the bank deposit (or approves it, including the authority to change it) and also does the bank reconciliations. Cash is taken and hidden by inflating "deposits in transit" on the bank reconciliation, underadding the outstanding checks list, or by simply omitting one or more outstanding checks from the list.

Just using basic checks and balances, *especially dividing duties*, will eliminate these kinds of problems.

Continued on page 6

Everyone that collects cash, over the counter must have his/her own cash drawer.

The Why and How of Checks and Balances

Continued from page 5

6. Wait a minute! OK, I can see why we've got to divide these duties up among different people. But—what if I just don't have the three or four people that you say it takes to do this properly?

Good checks and balances can be applied to the smallest of offices—even if you have just one or two on your staff, and even if you are the only one.

What you do is apply compensating measures to make up for not having appropriate division of duties. We'll talk about these measures later.

For now, though, note that even with just two people available, you can at least have them perform alternating steps in the process, and have them check each other's work. Remember, fraud is almost always committed by one person acting alone. When collusion is necessary, the chances for fraud are low.

If there's just one person, you'll need help from outside your office in order to establish a reasonable system of checks and balances. Such help should be readily available in counties from the county auditor and the county treasurer. Many cities have an internal audit staff or finance department that can be closely involved in the internal control process in the small office. In the smallest cities, the city council may need to get involved in order to provide the proper checks and balances.

7. So how should these duties be divided up?

Ideally, any one person should be involved in only ONE of the following types of duties:

(1) Authorization/ approval of transactions

(2) Recording of transactions

(3) Custody of assets

No one person should be involved in all three types of duties.

Ideally, one person should be involved in only one type of duty.

If duties are properly divided:

- collusion will usually be necessary for ongoing fraud—and collusion usually doesn't happen.
- whatever fraud might occur will probably be caught early.
- errors will probably be caught early.

To see if the duties are properly divided, and to help you plan an appropriate division of duties for your office, use the simple worksheet on page 22.

Now, there's one other thing that ought to be separated, too—cash drawers. Everyone that collects cash, over the counter must have his/her own cash drawer. This is essential.

Separate keys or separate ID numbers on the register just don't work. Separate cash drawers are the ONLY way to establish accountability for the money.

One Texas local government had over $120,000 embezzled from its cash drawers and could not pinpoint who was responsible because several people had access to the same cash registers. As a result, most of the money was never recovered, and innocent people were under suspicion.

8. Now let's talk about small offices.

If you don't have enough people for a good division of duties, we've listed below several things you can do to help make up for it.

You may not need to use all of these. To the extent that you can't use one, use another. For example, if it's impossible to get closer supervision, you may need to do special double-checking of work instead.

Check with your financial officials to see which procedures would be appropriate. Or, call us—the Local Government Program at the

Continued on page 25

State Court Costs and Fees for County and District Courts
(Revised)
September 1988

OFFENSE/DESCRIPTION	JCPT	LEOSE	CVC	CJP	OCL	AF*
Parking and Pedestrian	NA	NA	NA	NA	NA	3.00
Failure to Maintain Financial Responsibility						
• 1st Offense	1.00	1.50	3.00	5.00	75.00	3.00
• Subsequent offenses	1.00	1.50	15.00	10.00	75.00	12.00
Other State Law						
Class C Misdemeanors						
• Punishable by a fine of $200 or less	1.00	1.50	3.00	5.00	NA	3.00
• Punishable by a fine of more than $200	1.00	1.50	15.00	10.00	NA	3.00
Class A/B Misdemeanors	1.00	1.50	15.00	10.00	NA	12.00
Felonies	1.00	1.50	20.00	20.00	NA	NA

Other State Fees
Marriage License - $25.00 ($12.50 to state; $12.50 kept by county).
District Court Filing Fee - $40.00

*If arrest is made by a local peace officer, the Arrest Fee is sent to the jurisdiction making the arrest.

The Why and How of Checks and Balances, *Continued from page 6*

Comptroller's Office (toll-free, 1-800-531-5441, extension 3-4679).

(NOTE: Even if you do have enough staff to set up a good separation of duties, you will want to use some of these ideas. They'll just further strengthen your checks and balances and contribute to a smoothly running, efficient and effective office.)

(1) If you have at least two people in the office, break up the sequence of events in the cash handling process at one or more points so that one person does not handle the cash and the accounting for the cash from beginning to end. (See the example on page 24.) Also, break up the sequence of events in any other process involving valuables, such as inventorying equipment, small tools, unused receipts, etc.

Usually, just the knowledge that an auditor may walk in the door and look anyplace at any-time is enough to deter most frauds.

(2) Cross-train the people that you do have, so that each one knows what the others are doing and—just as important—knows what the others *should* be doing and *should not* be doing. This will help prevent errors and fraud. It will also mean that the work will get done right and on time even when someone is absent—others can easily step in and do the work.

(3) Rotate duties periodically among your staff. This will help cross-train them and allow them to spot others' errors and deliberate falsifications more readily. But do not always rotate the

Continued on page 26

The Why and How of Checks and Balances, *Continued from page 25*

duties on a regular schedule, and do not always rotate them among the staff in a regular pattern. There should be a certain element of surprise. This will help prevent someone from starting and perpetrating an ongoing fraud in any one area.

(4) Closer supervision than would otherwise be necessary may be required in the smaller office in order to help prevent and catch errors and fraud. While it takes more time, closer supervision is also usually easier in the smaller office, with fewer people to supervise.

(5) Special double-checking of work by the official/ department head may be necessary in the small office in order to ensure that irregularities—accidental or otherwise—are detected.

(6). Enforced vacations must be the rule for anyone that has conflicting duties, or that has access to cash—including the official or department head. There should be no exceptions. Someone else must do the vacationer's work in his/her absence. Many errors and frauds have been uncovered by applying this rule.

(7). Make sure that all employees are especially well-trained for their jobs. Employees that know what they're doing don't make many mistakes, and usually catch those that are made before they've done any damage.

(8). Have more internal auditing done for your smaller office than would be done for a larger office that had an adequate separation of duties—or at least have your staff *believe* that more internal auditing may be done at any time. Usually, just the knowledge that an auditor may walk in the door and look anyplace at any time is enough to deter most frauds.

9. What does the second principle, qualified personnel, mean?

It means that the people doing the work should have the ability to do the work:

- They should have an appropriate background before they are hired.
- They should get appropriate training when they start to work.
- They should get appropriate refresher and update training as necessary.

Employees that do not have the necessary skills do not do the work properly. The results are numerous mistakes and sloppy work—and a lot of headaches for the official or department head.

Check the education and job references of the applicants you think are qualified.

It's also very important to keep employees up to date with changes in state and local laws, regulations, and procedures and policies. In one case, a bookkeeper was not informed of a change in state fees collected by a local government office. As a result, the office ran up a cash shortage of over $6,000 before the oversight was discovered.

10. How can I help ensure that my staff has the ability to do the work?

It's not that hard. All you need to do is to be careful during the hiring process, and make sure that you have a regular program of training and updating.

Of course, the people you hire may not always have to be qualified to do the exact job you want them to do when they first come aboard. But, they should be easily trainable, and at least have the necessary general background. This is especially true if you don't have the time to train them in the very basic, common skills that you may need , like typing, bookkeeping, auto repair, heavy equipment operation, and so on.

Check the education and job references of the applicants you think are qualified. While it's true that some employers will not give out anything except dates worked and position held, many will verify a former employee's ex-

perience and skills. You might be surprised at the number of applicants that will fudge—or lie outright—about their education, skills, and past work experience.

Once a new person is on the job, be extra careful to ensure that she/he gets excellent training in the new job, including office policies and procedures.

And don't forget the refresher and update courses. Many offices hold regular weekly or monthly sessions to explain changes in policies and procedures, and just to discuss job-related problems.

11. What does the third principle, sound procedures for authorizing, recording, and reporting transactions, mean?

It means that procedures should be clearly and thoroughly:

(1) Defined.
(2) Documented.
(3) Disseminated.
(4) Done.

These are the "four D's" for office procedures. Here's what they mean.

(1) Procedures must be *clearly defined*, in plain English, and leave no room for doubt as to:

- what must be done
- how it is to be done
- when it is to be done
- who is to do it—including proper division of duties
- what paperwork goes where
- who is to check/approve the work
- where to go for help with the procedures.

(2) Procedures must be *well documented*—and this almost always means written down in a manual. If you want things done consistently and right, time after time, whether by new staff or by the old-timers, you just cannot rely upon peoples' memories. (Procedures manuals can also be a valuable training tool).

One fast way to get a procedures manual is to have everyone in the office write down what they do and how and when they do it. This may give you a pretty good idea of what is actually done in your office. Hopefully, it will be the right things getting done in the right way—but if not, you will have discovered this, and can revise the procedures.

If you need examples of procedures that follow good internal control principles, look at the Comptroller's accounting manuals for counties (the "Red Book"); for cities (the "Blue Book"); for justices of the peace (city courts have also found this book helpful); and for county indigent health care programs. Just call us if you need a copy.

(3) The best procedures are of no use if they are not *communicated* to those that have to use them. Make sure that everyone has a copy of the procedures. And keep the procedures up-to-date!

(4) Even if everyone has a really good and up-to-date procedures manual, it's all for nothing if the procedures aren't followed. This is the fourth "D"—the procedures must be *done*.

12. And that brings us to the fourth principle of good checks and balances, doesn't it? Sound performance.

Right. You have to make sure that the procedures are in fact being followed. There are many ways to do this. A lot of it involves just checking up on the work, and watching staff do the work.

But there some things you can do to make this job of checking on the performance of procedures a little easier and more reliable. We'll talk about them in a future issue, when we show county and city officials and department heads how they can audit their own offices.

In setting up and implementing your system of checks and balances, you should listen to the advice of your county and city finance and audit staffs, and your outside auditing firms. Remember the local government mentioned above that lost $120,000, in part because they didn't have separate cash drawers? Before the embezzlement ever started, the government's internal auditors had recommended changes in the way cash was handled—but not all the recommendations were adopted!

Now, if you have any questions, need more information, or want to discuss how to apply good internal control checks and balances to your office, just call us—the Comptroller's Local Government Program, toll-free, 1-800-531-5441, extension 3-4679.

Oh, and don't forget to take the quiz on page16.

How Good Are Your Checks and Balances?

Use this easy questionnaire to find out!

So you think you have pretty good internal control over the money and financial procedures in your office?

So you think your present checks and balances will prevent or catch any errors or fraud before they get out of hand?

Let's find out!

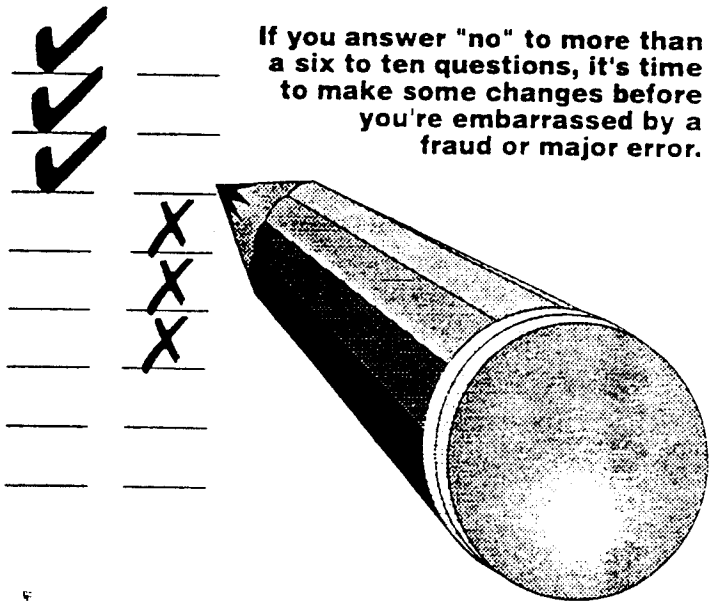
Just take this questionnaire and fill it out for your office.

If your checks and balances and other procedures are really in place and working, you should be able to answer *"yes"* to just about every question.

If you come up with more than six to ten *"no's"*, it's time to get to work and make a few changes *before* you're embarrassed by a fraud or major error.

Of course, as discussed elsewhere in this issue, no system of checks and balances is foolproof. But a good system of internal control can prevent most errors and fraud, ad certainly catch most of them before they become a serious problem.

While all these checks and balances are necessary, a few are more critical that the rest. *An appropriate division of duties is especially important.* For a discussion of this simple yet basic idea, see page 4 of the internal control discussion in this issue.



If you answer "no" to more than a six to ten questions, it's time to make some changes before you're embarrassed by a fraud or major error.

To apply this principle to your office, try the "Division of Duties Worksheet" on page 22.

Another of the most basic ideas is *separate cash drawers for each person that handles cash.* See page 6 for more information.

Periodic audits are another good check and balance. County auditors and treasurers have audit responsibilities assigned to them by Texas law. Cities of any size should have someone on staff who performs regular internal audits of the various city offices (this person could also perform other duties).

Remember, it is not the primary responsibility of your independent auditor to find and correct your errors, weaknesses, and possible fraud. Your outside CPA is concerned mainly with expressing an opinion on your financial statements. Safeguarding the taxpayer's money and property is *your* responsibility.

If you have any questions or problems with this checklist, just give us a call: the Local Government Program at the Comptroller of Public Accounts: toll-free, 1-800-531-5441, extension 3-4679.

Internal Control Checklist

General	Y	N	NA	Comments
1. Is there a procedures manual for the office?	—	—	—	
2. Is the manual up to date and does it cover all duties and responsibilities?	—	—	—	
3. Is the manual periodically reviewed and updated?	—	—	—	
4. Are the officials' and employees' duties and responsibilities well defined?	—	—	—	
5. Are duties periodically rotated?	—	—	—	
6. Is everyone required to take vacations?	—	—	—	
7. Is the work of persons on vacation performed by someone else during their absence?	—	—	—	
8. Is the official/department head appropriately bonded?	—	—	—	
9. Are other employees appropriately bonded?	—	—	—	
10. Is the adequacy of bonds periodically reviewed?	—	—	—	
11. Are employees performing their duties appropriately?	—	—	—	
12. Are they adequately trained?	—	—	—	
13. Are training needs periodically assessed?	—	—	—	
14. Is the workload current?	—	—	—	
15. Is the office not overstaffed?	—	—	—	
16. Is the office not understaffed?	—	—	—	
17. Is there an inventory of all tangible assets?	—	—	—	
18. Is the inventory up to date?	—	—	—	
19. Is responsibility for the assets fixed?	—	—	—	
20. Is the inventory periodically reviewed and the assets accounted for?	—	—	—	
21. Is the office audited periodically by internal/ external auditors	—	—	—	
22. Are appropriate recommendations implemented?	—	—	—	

General	Y	N	NA	Comments
23. Are the appropriate recommendations implemented timely?	—	—	—	
Receipts				
1. Are receipts used for all intakes of money?	—	—	—	
2. Are all receipts prenumbered?	—	—	—	
3. Are unissued receipts adequately controlled?	—	—	—	
4. Are all receipts periodically accounted for?	—	—	—	
5. Do receipts contain space for adequate information?	—	—	—	
6. Are all receipts dated and signed or initialed by the person issuing them?	—	—	—	
7. Are receipts filled out when the money is received?	—	—	—	
8. Is a receipt given to each person paying money?	—	—	—	
9. Are all checks appropriately filled out before a receipt is given?	—	—	—	
10. Are all checks immediately stamped with a restrictive endorsement?	—	—	—	
11. If applicable, are receipt amounts compared to supporting documentation to ensure amount is correct?	—	—	—	
12. Is all money received adequately safeguarded until remitted to the appropriate party or deposited in the bank?	—	—	—	
13. Do the receipts have at least three parts?	—	—	—	
14. Is a copy of the receipt retained by the office?	—	—	—	
15. Is a copy of the receipt given to the accounting office?	—	—	—	
16. Does each person receiving cash have a separate cash drawer or register?	—	—	—	
17. Is access to cash drawers or registers restricted to the individuals responsible for them?	—	—	—	
18. Does each person with a cash drawer or register balance out daily?	—	—	—	
19. Is the balancing verified by someone not receiving money?	—	—	—	

Continue questionnaire on page 12

Receipts	Y	N	NA	Comments
20. Are amounts collected appropriate?	—	—	—	_____
21. Is each person receiving money aware of the amounts to be collected?	—	—	—	_____
22. Are fee/fine/cost charges to be collected periodically reviewed to verify they are correct?	—	—	—	_____
23. Does someone other than the person receiving money prepare the bank deposit?	—	—	—	_____
24. Are bank deposits made daily?	—	—	—	_____
25. Are the different copies of the same receipts periodically reviewed to make sure they are identically filled out?	—	—	—	_____
26. Are receipt copies periodically compared with bookkeeping entries?	—	—	—	_____
27. Are change funds accounted for?	—	—	—	_____
28. Is the adequacy of change fund amounts periodically reviewed?	—	—	—	_____
29. Is mail opened daily?	—	—	—	_____
30. Is mail opened by someone other than those taking over-the-counter receipts?	—	—	—	_____
31. Is a record prepared by the person opening the mail of the checks and cash received?	—	—	—	_____
32. Is the bank deposit prepared by someone other than the person opening the mail?	—	—	—	_____
33. Are checks received through the mail immediately stamped with a restrictive endorsement?	—	—	—	_____
34. Are mail receipts deposited daily?	—	—	—	_____
35. Is there a system to account for installment or periodic payments?	—	—	—	_____
36. Are all outstanding amounts known and accounted for?	—	—	—	_____
37. Is there a system to keep up with when the payments are due?	—	—	—	_____
38. Is there a control total for all outstanding amounts?	—	—	—	_____
39. Is the control total periodically compared to subsidiary records?	—	—	—	_____
40. Is there a sufficient amount of double-checking of others work?	—	—	—	_____

Receipts	Y	N	NA	Comments
41. Does the amount of double checking increase/ decrease when staff size decreases/increases?	—	—	—	
Disbursements				
1. Are all disbursements made by check?	—	—	—	
2. Are all checks prenumbered?	—	—	—	
3. Are all checks preprinted with the name of the city or county and other specific information as appropriate, such as the name of the office and the name of the official?	—	—	—	
4. Are all unused checks accounted for and adequately safeguarded?	—	—	—	
5. Are checks prepared only when supporting documentation is present and after such documentation is verified?	—	—	—	
6. Are checks prepared and mailed or delivered timely?	—	—	—	
7. Are checks approved by someone other than the person responsible for the bookkeeping function?	—	—	—	
8. Is the payee line completed on all checks prior to approval?	—	—	—	
9. Are checks prevented from being pre-signed?	—	—	—	
10. Are checks prevented from being made out to "cash" or "bearer"?	—	—	—	
11. Are all voided checks marked "void" and accounted for?	—	—	—	
12. Are authorized check signatures kept to a minimum?	—	—	—	
13. If a stamp or check signing device is used, is it appropriately safeguarded and is access appropriately restricted?	—	—	—	
14. Are checks mailed without allowing them to be returned to the person who approves them or does the bookkeeping of them?	—	—	—	
15. If applicable, are supporting documents cancelled upon payment?	—	—	—	
16. Is there a sufficient amount of double-checking of others work?	—	—	—	

Continue questionnaire on page 14

Disbursements	Y	N	NA	Comments
17. Does the amount of double-checking increase/decrease when staff size decreases/increases?	—	—	—	
Bank Accounts				
1. Are only the minimum number of bank accounts maintained?	—	—	—	
2. Are balances appropriately safeguarded via provisions in the depository contract and FDIC coverage?	—	—	—	
3. Are bank statements reconciled promptly upon receipt?	—	—	—	
4. Are reconciliations done by someone other than the person who prepares bank deposits and approves checks?	—	—	—	
5. Does the person who reconciles the bank statements receive those statements unopened from the bank?	—	—	—	
6. Are deposits shown on the bank statement compared with accounting records as to date and amount?	—	—	—	
7. Are any service charges verified as to amount?	—	—	—	
8. Are cancelled checks compared to the accounting records as to check number, date, amount and payee?	—	—	—	
9. Are all cancelled checks accounted for?	—	—	—	
10. Are cancelled checks examined for alterations?	—	—	—	
11. Are cancelled checks examined for irregular endorsements?	—	—	—	
12. Are cancelled checks examined for unauthorized signatures?	—	—	—	
13. Are items returned or rejected by the bank properly investigated and accounted for?	—	—	—	
14. Are completed bank reconciliations reviewed and approved by someone other than the person doing the original reconciliation?	—	—	—	
15. Is there a time period or date printed on the checks after which they become void?	—	—	—	
16. Are outstanding checks appropriately handled and accounted for once they become void?	—	—	—	
17. Is pre- or post-dating of checks prohibited?	—	—	—	

Accounting, Bookkeeping, Reporting	Y	N	NA	Comments
1. Is a bookkeeping system maintained to account for all financial-related transactions?	___	___	___	_____
2. Are books of original entry (journals) maintained?	___	___	___	_____
3. Are adequate subsidiary records maintained?	___	___	___	_____
4. Are transactions entered daily?	___	___	___	_____
5. Are transactions entered from appropriate sources (i.e., receipt copies, check copies)?	___	___	___	_____
6. Are daily entries verified for mathematical accuracy?	___	___	___	_____
7. Are entries periodically reviewed by someone other than the person making them, comparing the entries with appropriate source documents?	___	___	___	_____
8. Is there a good audit trail for all transactions from source documents to accounting entries and from accounting entries to source documents? That is, can someone who does not work in the office easily trace all records of transactions from source documents to books to reports?	___	___	___	_____
9. Are the records that are required by law actually maintained (such as docket books, receipts, requisitions, claims registers, etc.)?	___	___	___	_____
10. Is all required information entered on these records?	___	___	___	_____
11. Are entries to these records current?	___	___	___	_____
12. Are these records periodically compared to source documents and other accounting records for accuracy?	___	___	___	_____
13. Are bookkeeping functions performed by someone other than the people receiving cash, preparing bank deposits and approving disbursements?	___	___	___	_____
14. Are reports prepared and submitted timely?	___	___	___	_____
15. Are reports compared against accounting records for accuracy?	___	___	___	_____
16. Are reports reviewed and approved by someone other than the person preparing them?	___	___	___	_____
17. Are reports audited monthly by the appropriate city or county office?	___	___	___	_____

Continue questionnaire on page 16

Accounting, Bookkeeping, Reporting	Y	N	NA	Comments
18. Is there a sufficient amount of double-checking of others' work?	__	__	__	_____
19. Does the amount of double-checking increase/decrease when staff size decreases/increases?	__	__	__	_____

How Well Do You Know Your Checks and Balances?

Test yourself—take this self-quiz.

Questions are based on information in this issue, including the articles and the questionnaire beginning on page 9. They cover the basics of internal control. There are no trick questions, and there's only one correct answer to each question. Correct answers and scoring are on page 20.

Good luck!

1. Good internal control guarantees that operations are 100% correct.
   T___ F___

2. It is impossible to have good internal control in a small office.
   T___ F___

3. Which of the following is not a purpose of internal control?
   a. safeguard assets.
   b. accurate and reliable data.
   c. hide errors and irregularities.
   d. encourage adherence to laws and policies.

4. Internal control is important even if your office doesn't handle any money.
   T___ F___

5. A good system of internal control can:
   a. prevent all errors and irregularities.
   b. help detect errors sooner than they would have been otherwise.
   c. ensure re-election for the official.
   d. ensure a good audit report from the outside auditor.

6. A system attempting to assure that no errors or fraud exist would not be worth the cost.
   T___ F___

7. Good internal control principles should be applied to:
   a. only those offices with 3 or more people.
   b. only those offices with less than 3 people.
   c. any office, no matter how large or small.
   d. only those offices that do not have internal audits.

8. Which of the following are basic principles of internal control?
   a. appropriate division of duties.
   b. qualified and trained personnel.
   c. sound procedures for authorizing, recording, and reporting transactions.
   d. all of the above.

9. It is okay for one person to handle a sequence of related transactions from beginning to end as long as the person is careful to double-check his or her own work.
   T___ F___

10. Ideally, if a person does the bookkeeping in an office, they should not also:
    a. issue receipts.
    b. prepare bank deposits.
    c. sign checks.
    d. do any of the above.

11. Which of the following is not one of the 3 basic functions that should be segregated for a proper division of duties?
    a. authorization/approval of transactions.
    b. supervising the office.
    c. recording of transactions.
    d. custody of assets.

12. It is much easier to catch errors if one person performs two or three of the basic functions (authorization/approval, recording, and/or custody).
    T___ F___

13. If staff size is limited, which of the following steps should not be taken to help assure reliable internal control?
    a. less supervision.
    b. enforced vacations.
    c. rotation of duties.
    d. cross-training.
    e. more internal auditing.

14. Having qualified personnel isn't important as long as someone else checks their work.
    T___ F___

15. Qualified personnel means:
    a. people doing the work should have the ability to do the work.
    b. they should have the proper background before they are hired.
    c. they should get appropriate training when they start to work.
    d. a and c, but not b.
    e. a, b and c.

Continue quiz on page 18

16. Sound procedures for authorizing, recording and reporting transactions should include:
    a. what must be done.
    b. how to do it.
    c. who is responsible for doing it.
    d. b and c, but not a.
    e. a, b and c.

17. Sound procedures should provide for:
    a. proper division of duties.
    b. logical flow of documents.
    c reasonable amount of checking and verification.
    d. all of the above.
    e. only b and c.

18. Just having appropriate division of duties, qualified personnel, and sound procedures isn't enough—they have to be followed.
    T___ F___

19. The best way to stop kiting and lapping is to have a comprehensive procedures manual written in plain English.
    T___ F___

20. It is okay for two people to use the same cash drawer as long as receipts are initialed.
    T___ F___

21. It is not necessary to make daily bank deposits as long as the money is locked up overnight.
    T___ F___

22. Restrictive endorsements should be put on checks as soon as they are received.
    T___ F___

23. Change funds should always be in the amount of $100.00 to simplify balancing at the end of the day.
    T___ F___

24. Control should be maintained over
    a. issued receipts.
    b. unissued receipts.
    c. issued checks.
    d. unissued checks.
    e. all of the above.
    f. only a and c.

25. Receipts should be filled out with:
    a. permanent ink.
    b. pencil.
    c. erasable ink.
    d. all receipts should be typed.

26. Enforced vacations should only be considered when the office workload is current.
    T___ F___

27. When someone who has responsibility for money or books is on vacation, their work should:
    a. not be done by anyone else because it might not get done correctly.
    b. only be done if its urgent and can't wait.
    c. be done in its entirety by someone else during their absence.
    d. be done by someone else or saved until the employee returns, whatever the employee thinks is best.

28. Checking the adequacy of personal bonds is an important internal control procedure.
    T___ F___

29. When there is a long line of people waiting to make a payment in a city or county office, it is okay not to give payors a receipt when payment is made as long as one is mailed to them later.
    T___ F___

30. As long as a restrictive endorsement includes the phrase "for deposit only" it is not necessary for the account number to be included.
    T___ F___

31. The receipt forms used by the city or county should be:
    a. a one part form.
    b. a two part form.
    c. at least a three part form.
    d. one, two or three parts, depending upon how much money is normally received in a month.

32. The purpose of a change fund is to help employees "make it" until payday.
    T___ F___

33. It is illegal for a "stamp" or "checksigning" device to be used in Texas cities and counties.
    T___ F___

34. Voided checks should be marked "void" and be accounted for.
    T___ F___

35. Cancelled checks should be examined for:
    a. alterations.
    b. irregular endorsements.
    c. unauthorized signatures.
    d. a, b and c.
    e. b and c, but not a.

36. It is preferable to post-date a check if there is currently not enough money in the bank to cover it.
    T___ F___

Continue quiz on page 20

37. Source documents, such as receipts, should periodically be compared with bookkeeping entries and reports for comparability.
T___ F___

38. The best time to do a bank reconciliation is:
a. promptly, upon receipt.
b. 10 days after the postmark date to allow final check clearing.
c. anytime within one month of receipt.
d. between 7 and 14 business days after receipt.

39. A time period or date should be printed on checks, after which they become void.
T___ F___

40. As long as the books and reports balance, it is not necessary to examine individual transactions.
T___ F___

Answers to Internal Control Self-Quiz

(Quiz Begins on Page 8)

1. F	15. E	29. F
2. F	16. E	30. F
3. C	17. D	31. C
4. T	18. T	32. F
5. B	19. F	33. F
6. T	20. F	34. T
7. C	21. F	35. D
8. D	22. T	36. F
9. F	23. F	37. T
10. D	24. E	38. A
11. B	25. A	39. T
12. F	26. F	40. F
13. A	27. C	
14. F	28. T	

SCORING:
0 wrong: few or no problems in your office—as long as you apply what you know!
1-5 wrong: not bad at all—you're probably doing OK in your office.
6-10 wrong: you sure tried, but you need to read the articles more closely!
10+ wrong: Are you sure you read the articles in this newsletter?

Division of Duties Worksheet

If your office handles money, use the worksheet on page 22 to see if there is an adequate division of duties between those who handle cash and those who keep the books and authorize transactions.

For each person in your office, put an "X" by the duties that he or she has. Add more columns if your office has more than four persons (including the official or department head). *You may also need to add more duties/responsibilities to cover your own particular situation.*

Ideally, no one should be involved in more than one type of duty. That is, Person A should have "custody" duties only, and should not be keeping books or signing checks. Person B might be involved with bookkeeping, and should not have any "custody" or "approval" duties checked.

Of course, a single person may have several different individual duties. But those duties involving financial business should be of only one type.

If you find persons with conflicting types of duties (that is, with more than one type of duty checked), start a new worksheet. Use it to assign duties to each person in such a way that each person will have only one type of duty.

In many offices, especially smaller ones, this may be very difficult, if not impossible. Even in larger offices, it's not always practical to have a complete division of duties. If you can't come up with an ideal plan, then do the best you can—and recognize that you and the internal auditor will have to see that other steps are taken to maintain proper checks and balances. For a discussion of these other steps, see page 5. They are summarized below.

Good luck!—and remember, the Comptroller will be happy to help you with any problems you may have in using this worksheet, from filling it out the first time to planning an appropriate segregation of duties in your office.

Just call us toll-free, 1-800-531-5441, extension 3-4679—the Local Government Program.

What to do When You Can't Divide Duties Properly

Here's a quick list of the basic remedies to use when you can't appropriately divide the duties in your office.

Select as appropriate, preferably in consultation with city/county auditors, treasurers and other financial officials.

A fuller discussion of these prescriptions is found beginning on page 5.

1. No one person should handle, record, and/or approve money from the time the office gets it to the time it pays it out. If a single person must handle several duties of the same type, try to bring in someone else to break the sequence at one or more points.
2. Make extra efforts to ensure that all staff is well-trained.
3. Cross-train employees in the various duties and responsibilities of the office.
4. Rotate duties periodically among all the employees.
5. Supervise employees more closely.
6. Have the supervisors/department head/official do more and closer double-checking of work.
7. Require that everyone that handles money take at least a week of vacation; have someone else do that person's work while they're away.
8. Have more internal auditing done in the office, especially more surprise audits.

Division of Duties Worksheet

Duty/Responsibility	Type	Person A	Person B	Person C	Person D
Involving Money:					
Receive money/issue receipts	Custody				
Open and list mail receipts	Custody				
Prepare bank deposits	Custody				
Review/approve bank deposits	Approve				
Record receipts	Record				
Access to unused receipts	Custody				
Take inventory of unused receipts	Record				
Prepare disbursements	Record				
Sign checks	Approve				
Record disbursements	Record				
Access to unused checks	Custody				
Take inventory of unused checks	Record				
Prepare billings and delinquency letters	Approve				
Reconcile bank statements	Record				
Review/approve bank reconciliations	Approve				
Prepare monthly reports	Record				
Review/approve monthly reports	Approve				
Not involving money:					
Use of furniture, equipment, tools, vehicles, and other physical assets	Custody				
Take inventory of physical assets	Record				
Review/approve inventory of physical assets	Approve				
Fill out own time cards	Custody				
Review/approve time cards	Approve				
Use time cards to calculate payroll	Record				

Special Internal Control Note

For Old And New County Tax Collectors

Curt Swenson, the Comptroller's motor vehicle tax expert, had several words of advice about state laws and checks and balances for county tax assessor-collectors as this issue went to press.

"As county tax officials, you handle a lot of money and have a wide range of financial responsibilities, locally and to the state" said Swenson. "What it all comes down to is that you are responsible for every penny. So, *bonding* is an important part of your system of checks and balances."

You need to be bonded to both the county and to the state, he said. Your employees should also be bonded, as well as any automobile dealers and title services that serve as your deputies.

Swenson pointed out that the Comptroller must keep up to date with who is collecting and handling the state's revenues. "It's really very important to notify us just as soon as there is a change due to election, resignation or appointment. We need to keep up with your bonds and set up new accounts for you for motor vehicle sales tax collections. Also be sure to notify the appropriate State Department of Highways and Public Transportation, Division of Motor Vehicles personnel."

Swenson reviewed the basics of bond filing, as required by state law:

- New county tax assessor-collectors must post a bond payable to the governor to cover state taxes and fees collected.
- Re-elected tax assessor-collectors must post a new bond upon entering their new term of office.
- The amount of the bond is five percent of the previous year's collections of motor vehicle taxes and registration fees, up to a maximum of $100,000.
- The Comptroller notifies each county of the required bond amount as soon as possible.
- The Comptroller provides the bond form for motor vehicles taxes and fees.
- Send the form to the Account Maintenance Division at the State Comptroller's Office.
- Even if you're appointed to fill out a very short unexpired term—even just a month or two—the same bond is still required by state law.
- You must also be bonded to your commissioners court for collecting the property taxes of your county (see Section 6.28 of the Property Tax Code).
- You may need to be bonded if you collect taxes for other taxing units (see Section 6.29 of the Property Tax Code).

Swenson also suggested that new county tax officials set up new bank accounts in order to keep their money separate from their predecessor's.

"Another good idea is to have the county auditor and/or treasurer audit the office and count the money

Continued on page 8

Internal Control, *Continued from page 7*

and various inventories when the outgoing official leaves."

Swenson said the idea is to make a clean start with your own new accountability.

"All this helps protect you, the county and the state", said the tax expert. "But you really need to go a step further. Any employee that has access to cash or other valuables, like stickers, should also be bonded–preferably for a substantial proportion of the full amount that she or he has access to. It's one of the basics of good checks and balances."

Swenson also urged county tax officials to require bonds from dealers and title services that act as official deputies for collecting motor vehicle taxes and fees. "Again, it's for your own protection against accidental loss as well as deliberate fraud. They've got your money and your inventories out of your sight and away from your control."

He also noted that just because somebody is bonded is no guarantee that there haven't been problems with that person in the past or that there won't be problems in the future. "But, if the bonding company refuses to bond someone, then at least you've been alerted to a potential problem before it starts. And, if they are bonded, you've got some protection."

Questions about bonding, or motor vehicle taxes and fees? Call the expert–Curt Swenson is available at the Comptroller's toll-free number, 1-800-531-5441, extension 3-4684. If he's busy, ask for extension 3-3968.

The Most Common Frauds

Here are some of the most common ways that officials and employees put your city's or county's money in their own pockets. *All* of these methods are *easily* preventable and detectable *before* they start or get out of hand–*IF* you have a reasonably good system of checks and balances.

- Collecting money over the counter or from the mail and not issuing a receipt.
- Using receipts from storage, that haven't yet been issued to cashiers.
- Using receipts that aren't official (for example, purchased by the cashier at the local five and dime).
- Collecting fines and costs on dismissed cases.
- Reporting reduced fines, while actually collecting the original amount.
- Writing checks to fictitious parties.
- Using checks from storage, that haven't yet been issued to the checkwriters.
- IOU's and personal checks in the cash drawers.
- Kiting (see page 5).
- Lapping (see page 5).
- Excessive travel reimbursements
- Using credit cards for personal use.
- Using other government property for personal use

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
THERE'S MONEY IN THE MAIL

APPENDIX 10.6 is comprised of excerpts from the March, 1991 edition of City and County Financial Management. It contains an in-depth discussion and questionnaires concerning internal controls on cash received through the mail.

CITY & COUNTY

Financial Management

March 1991 John Sharp, Texas Comptroller of Public Accounts

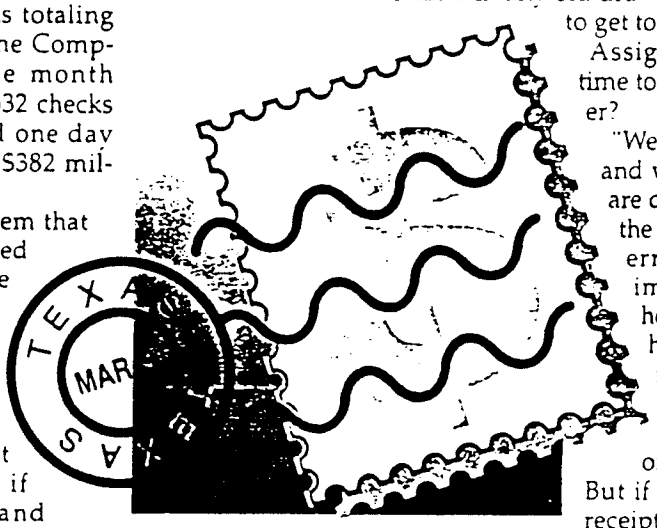
New checklist for efficiency and effectiveness

There's money in the mail...

...and there just may be trouble in the mail, too—lost cash, lost interest, undetected errors and taxpayer gripes!

Texas Comptroller John Sharp should know. In fiscal year 1990, the Post Office delivered more than 2.5 million checks totaling nearly $15 billion to the Comptroller's Office. One month alone, there were 371,532 checks for $1.75 billion. And one day saw 39,653 checks for $382 million.

"We must have a system that gets all the money added up correctly and in the bank right away," said Sharp. Taxpayers don't like inefficiency and lost interest, and you folks who get sales tax checks won't get the right amount if we don't accurately and quickly process our mail receipts."



Your county or city office may not handle the volume of mail money that the Comptroller does, but it's just as important that your mail receipts be properly and timely handled.

"We've developed a checklist for you to use to evaluate how well you handle your mail receipts," said Sharp.

The checklist, or "operational review," was developed by Rene Henry, a CPA and head of the Technical Assistance Section of the Comptroller's Local Government Division. It starts on page 3 of this issue.

Mail receipts tell all

What do you do with the money your office gets in the mail?

Stuff it in any old drawer until you have the time to get to it a month from now?

Assign it to whoever has the time to do it—like the bookkeeper?

"We've seen these situations and worse," said Henry. "Both are dangerous for the safety of the money and for preventing errors. But even more important, I can tell you how well an office is run by how they treat their mail receipts. If they handle them properly and timely, then the rest of the office is probably run well. But if they don't take the mail receipts seriously, undoubtedly there are problems in the rest of the office, too."

And it's not just the money

The other members of the Technical Assistance staff, all CPAs, agreed. Gordon Thomas pointed out that it's not just the safety of the money and lost interest that is involved. "It's also the impression that you give the taxpayer," he said. "County and city officials pay a lot of attention to how they treat taxpayers when they come into the office or when they call on the phone. But the same consideration is not always given to han-

See page 2

Index, p. 3 ■ Census count is out p. 10 ■ Sharp answers, p. 15

Sharp talk:

It's in the mail.....(honest)

When you visit or call the Comptroller of Public Accounts, whether at one of our field offices close to you or at our central office in Austin, you naturally expect prompt, courteous and professional service.

And it goes without saying that you expect timely and accurate information.

Well, the same holds true when you deal with the Comptroller by mail. Whether you send us a tax return, a question, a compliment or even a complaint, you have the right to expect prompt and accurate handling of your communication.

Of course, we process money through our office and into the treasury as fast as possible.

But we also have strict standards for other mail as well. Certain priority mail is answered in 24 hours. Other mail is answered in 72 hours. No exceptions.

If it's going to take us longer to find the correct answer, we'll get back to you within the 24-or 72-hour limit. We'll let you know we're working on your request and we'll tell you when we expect to have an answer. And when we say "it's in the mail," we mean it.

Handling mail in your city or county is just as important to you and to your taxpayers and constituents.

So, in keeping with my policy of helping local governments by making more information and options available to them, this issue of *City and County Financial Management* gives you information that can help you handle your mail receipts efficiently and effectively.

Our operational review checklist may save you money, earn you more interest, prevent errors and taxpayer complaints.

What more could you want? Well, I'd like to know!

I'd like your comments on our efforts to assist you. I'd like to know what we've done that you especially like, what we could do better and what we could do that we aren't doing.

Drop me a letter—*and I'll get back to you right away.*

John Sharp

State Comptroller of Public Accounts

dling mail receipts."

Consider, for example, the taxpayer who mails in his property taxes or traffic fine and two months later his check hasn't cleared his bank. "He wonders what he's paying for," said Thomas. "He doesn't get a good impression of the efficiency and effectiveness of his local government."

And Bob Mathison noted that people tend to remember and repeat the negative much more often than the positive. "The taxpayer who's treated badly will tell a lot more people than the taxpayer who's treated properly," he said.

Jim Edwards said that the lack of attention often paid to mail receipts is understandable, but unfortunate. He pointed out that paperwork simply stacks up in many offices, especially in those with seasonal peaks, like tax offices. "And there's usually no budget to hire more help," he said. "Of course, you're going to pay more attention to the immediate demands, like walk-in taxpayers and telephone calls. That's natural. But there's money to be lost and taxpayer wrath to be gained in letting the mail receipts get behind."

For more information

The operational review checklist includes sample procedures that you can use or adapt to your own mail receipt operations. In addition, you may want to review the August 1987 and December 1988 issues of *City and County Financial Management* that have detailed reviews of cash management and internal control. If you can't locate your copies, or if you need more information on any of these topics, just call us, toll-free: The Comptroller's Local Government Division, 1-800-531-5441, extension 3-4679. ▲

How well do you handle your money in the mail?

Use our handy operational review to evaluate how you're doing at processing your mail.

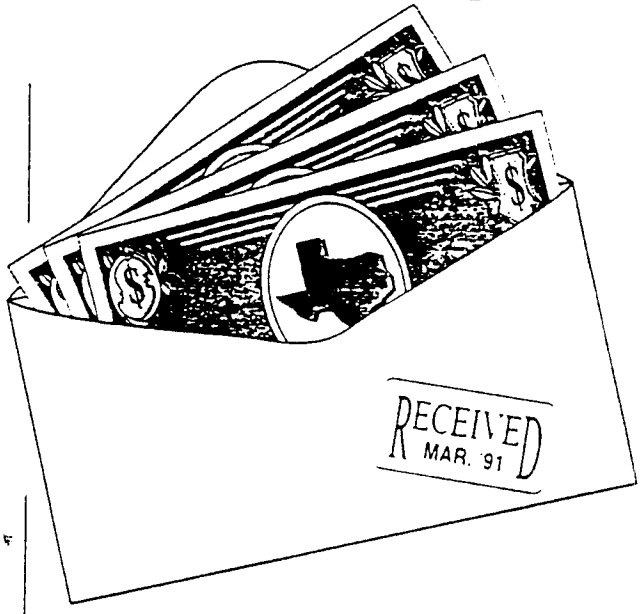
First, we suggest a few general procedures and show you a sample form for mail collections.

Then we ask you to grab a pencil and test your present system by answering 87 questions about your office procedures and internal control for mail in general, especially money received in the mail. This should give you a good idea of how your system stacks up against an ideal one.

As in our previous checklists, a *NO* answer to any question indicates an area for improvement.

Remember, nobody's perfect! You'll probably find several areas where you need to improve. Don't get discouraged. Just pick the most important areas and work on them first.

If you get stuck or if you don't understand the questions or how to implement an improvement—call us! We're happy to consult with you on any of these procedures and questions. It's a toll-free call to the Comptroller's Local Government Division, 1-800-531-5441, extension 3-4679.



Mail collection procedures

Proper management of mail collections is particularly important because the person making the payment is not present and no receipt is issued directly to the payor at the time of collection. Here are the general procedures for collecting and reporting mail receipts. Following them will help ensure proper processing, depositing and accounting of mail receipts, while also establishing a clear-cut audit trail.

General

1. The daily mail should be picked up by the designated mail cashier or should be delivered to the cashier unopened.
2. All mail should be opened by one person and all checks and currency removed prior to fur-

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the various sections?

2. Is there a procedure to identify mail that should receive priority treatment?
3. Is there a maximum time limit to work priority mail or to notify the sender that his correspondence is being worked on?
4. Is there a maximum time limit to work all other mail or to notify the sender that his correspondence is being worked on?
5. Are officials and employees aware of how important it is to have good procedures concerning the handling of mail?
6. Is there a procedures manual for the office that addresses the handling of mail?
7. Is the manual up-to-date and does it cover all duties and responsibilities?
8. Is the manual periodically reviewed and updated?
9. Are changes to the procedures done in writing with the reasons for the changes documented?
10. Are employees promptly notified of all changes?
11. Are the duties and responsibilities of officials and employees well defined?
12. Are duties and responsibilities periodically rotated?
13. Is everyone required to take vacations?
14. Is the work of persons on vacation performed by someone else during their absence?
15. Is the official/department head appropriately bonded?
16. Are other employees appropriately bonded?
17. Is the adequacy of bonds periodically reviewed?
18. Are employees performing their duties properly?
19. Are they adequately trained?
20. Are training needs periodically reviewed?
21. Is the workload current?
22. Is mail opened at least daily?
23. Is mail opened by someone other than those taking over-the-counter receipts?
24. Is a record prepared by the person opening the mail of the checks and cash received?
25. Is the bank deposit prepared by someone other than the person opening the mail?
26. Are checks received through the mail immediately stamped or otherwise restrictively endorsed?
27. Are citizens advised to never send currency in the mail?
28. Are citizens instructed to make sure checks are properly and completely filled out before being mailed?
29. Is there a procedure in place to send a receipt for mail collections to those who request one?
30. Are mail receipts deposited or remitted daily?

Interest earnings

1. Is there a list of all offices and departments that receive money through the mail?
2. For each office and department, does the list include the following?
   a. the types and amounts of collections received.
   b. the frequency with which bank deposits are made (if money is not remitted daily).
   c. what bank account(s) to deposit money in to pending remittance to the city/county treasurer.
   d. whether or not the accounts are interest-bearing accounts.
   e. the rate of interest being earned on interest-bearing accounts.
   f. the frequency that interest is compounded on interest-bearing accounts.
   g. the actual yield being earned on interest-bearing accounts.
   h. the rate of interest being earned on money after it is remitted to the city/county treasurer.
   i. the frequency that interest is compounded in "h" above.
   j. the actual yield being earned by the city/county treasurer.
3. Have lockboxes been investigated to determine if using them would result in additional interest earned?
4. Is there a list of mail pick up and delivery times for each office and department receiving money through the mail?
5. Is the list periodically analyzed to determine whether the pick up and delivery times can be changed to receive the money earlier?
6. Is mail worked promptly upon receipt so that money received can be deposited as soon as possible?
7. Is all mail with money worked daily?
8. Where applicable, are billings or payment notices prepared and mailed as soon as possible?
9. For each office and department that does not use interest-bearing accounts, has the lost interest been calculated?
10. For each office and department that does use interest-bearing accounts, have the additional net interest earnings from more frequent

deposits been calculated? (Note: Deposits should be made daily at a minimum. If this is not currently done, calculate the additional interest that would be earned by making daily deposits. If daily deposits are made, calculate the additional interest that would be earned by making deposits more than once a day.)

11. In figuring the additional net interest earnings in No. 10, have all possible additional costs, if any, been determined?
12. In determining the additional costs, have the following been considered?
    a. additional bank charges
    b. personnel costs
    c. other related costs (photocopying, forms, etc.)
13. For each office and department, have the additional net interest earnings from making more frequent remittances to the city/county treasurer been calculated? (Note: This could mean increasing the frequency to twice a month, weekly, twice a week, daily or more than once a day.)
14. In figuring the additional net interest earnings in No. 13 above, have all possible additional costs, if any, been determined?
15. In determining the additional costs, have the following been considered?
    a. additional bank charges
    b. personnel costs
    c. other related costs (photocopying, forms, etc.)
16. Do the personnel costs in Nos. 12 and 15 include the following?
    a. time needed to prepare the deposits/remittances
    b. time needed to make and deliver the deposits/remittances
    c. time needed to do the bookkeeping
    d. time needed to reconcile the bank statement
    e. city/county share of personnel costs (social security, retirement, etc.)
17. Has the impact of more frequent deposits and remittances upon other office work been considered? (for example, changing the time a certain duty is done to later in the day to allow for earlier preparation of the deposits/remittances)
18. In counties with a population of 50,000 or more, do county offices deposit money on or before the next regular business day after receipt? If not, do they deposit money received through the mail with the county treasurer no later than seven business days after receipt (Local Government Code, Section 113.022)?
19. In counties with a population under 50,000, do county offices deposit funds received with the county treasurer:
    a. at a time set by the commissioners court, at least seven business days and no more than up to 30 calendar days after they are received? or;
    b. if no time is set by the commissioners court, no later than seven business days after they are received?
    (Local Government Code, Section 113.022)

Checking the system to see if it's working

1. Is there a quality review system in place to routinely check some of the mail received to see how it was handled?
2. Is quality review work documented?
3. Does the review include checking the accuracy, timeliness and documentation of the work?
4. Are some of the senders periodically contacted to see if it was handled to their satisfaction?
5. If working the mail results in contact with the sender by telephone, are some senders contacted to see how professional, courteous, helpful and timely the city/county employee was?
6. Do employee evaluations include performance relating to handling mail?
7. Are all complaints, verbal or written, followed up to find out specifically what the complaint is, what caused it and if there is anything that can be done to improve or remedy the situation?
8. Are offices periodically audited by internal auditors?
9. Are some of the audits done on a "surprise" basis?
10. Do the internal audits include checking for the following?
    a. safety of money received in the mail
    b. how timely mail is worked
    c. how accurately mail is worked
    d. how efficiently mail is worked
11. Are appropriate recommendations made as a result of internal audits implemented?
12. Are the appropriate recommendations implemented timely? ▲

TEXAS ASSOCIATION OF COUNTY AUDITORS
AUDIT GUIDE
ESTABLISH INTERNAL CONTROL WITH FOUR GUIDING PRINCIPLES

APPENDIX 10.7 is comprised of excerpts from the March-April, 1994 edition of City and County Financial Management. It contains clear and practical approaches to establishing good internal control and an excellent internal control questionnaire.

CITY & COUNTY Financial Management

March-April 1994

John Sharp, Texas Comptroller of Public Accounts

Establish internal control with four guiding principles

Public officials and employees are expected to effectively, efficiently and economically manage the taxpayers' money and assets.

But despite the public's expectations for local government officials and employees to manage taxpayer dollars with that high degree of responsibility, we all hear about it in the headlines—fraud, embezzlement, mismanagement of money, errors in reporting and huge shortfalls that occur but remain undetected for years.

Guiding Principles of Internal Control

- **A separation of duties**
- **Qualified staff**
- **Sound procedures**
- **Sound performance of the first three**

We'd like to help by giving you some information on internal controls. Anytime something of value is involved, a good internal control system should be in place. If you don't have a good internal control system in place, now is the time to develop and implement one. If you already have a good system in place, maybe it's time to evaluate it.

Let's begin by explaining what constitutes a good internal control system. The four guiding principles of internal control are (1) a separation of duties, (2) qualified staff, (3) sound procedures, and (4) sound performance of the first three.

The guiding principles

1. *A separation of duties.* Duties should always be divided up among various staff members. No one person should handle related transactions from start to finish. Why? If an error is made, it may go undetected from start to finish. Remember, people don't often catch their own mistakes. Also, fraud is easier to commit because the same person that collects cash—and pockets a portion of it—can cover it up by making compensating entries to bank deposit slips, journals and ledgers, dockets, case files, taxpayer accounts, bank reconciliations, and even monthly reports. Unless duties are separated and there is more than one employee handling a transaction, no one else is available to detect that records have been falsified or that recorded data appears questionable.

2. *Qualified staff.* The people you hire may not know exactly what the job requires when they first come aboard. However, they should have the ability to be trained in their duties. They should also be capable of following procedures so they can detect errors and report possible fraud or mismanagement. Check the education, experience and skills of the staff you hire. Once a new employee begins working, be sure to provide proper training in office policies and procedures. And, don't forget to later provide refresher training when policies and procedures change. Cross-training also provides employee development when the employee masters his or her own duties.

3. *Sound procedures.* Employees need guidance on how to perform their jobs right. They need to know what is expected of them. You should have clearly

Continued on page 10

Letter from the Comptroller

Internal control can save taxpayer dollars

The public expects local government officials to wisely collect, report, spend, invest and account for their money and assets. Nothing less is acceptable. It is an enormous responsibility. A good internal control system can help you. But the system is only as good as the attention you give it. Continual monitoring and evaluating for efficiency and effectiveness becomes paramount. It is important because we still see instances of mismanagement of funds, fraud, embezzlement and errors that go undetected for years.

You may be thinking that your jurisdiction is safe from fraud and errors now, but that doesn't mean it won't happen in the future. Remember, the only way you can tell your system is working is when you uncover occasional errors or detect fraud in the early stages. Then you know the system works.

Your local jurisdiction isn't the only taxpaying jurisdiction that benefits by the implementation of a good internal control system. Errors and embezzlement can cost millions of dollars in lost revenue to the entire state. Better checks and balances mean that the monies you collect for your local government and the state are handled more accurately and timely. Money and assets that are appropriately used—and accounted for—benefit everyone.

As technology advances, re-evaluate and revise your policies and procedures—and your internal controls. To evaluate the system's performance, include the individuals who handle the money, inventory assets, supervise collections, authorize transactions, govern day-to-day decisions, invest your money and audit your accounts.

Remember, you are not setting up an environment of distrust. You are developing a healthy atmosphere of accountability and efficiency. With a good internal control system, you will protect innocent staff who are trying to perform good public service. You are also protecting your local and state governments' dollars and assets.

John Sharp

Texas Comptroller of Public Accounts

CITY & COUNTY

Financial Management

Articles and analyses appearing in City and County Financial Management do not necessarily represent the policy or endorsement of the Comptroller of Public Accounts. Space is devoted to a wide variety of topics of Texas interest and general government concern.

John Sharp, Texas Comptroller of Public Accounts

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