May 2016 CPA Training

WRITING FINDINGS FOR MORE IMPACTFUL RESULTS

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Key Points

- Improved communication of audit results
- Increase awareness of risks

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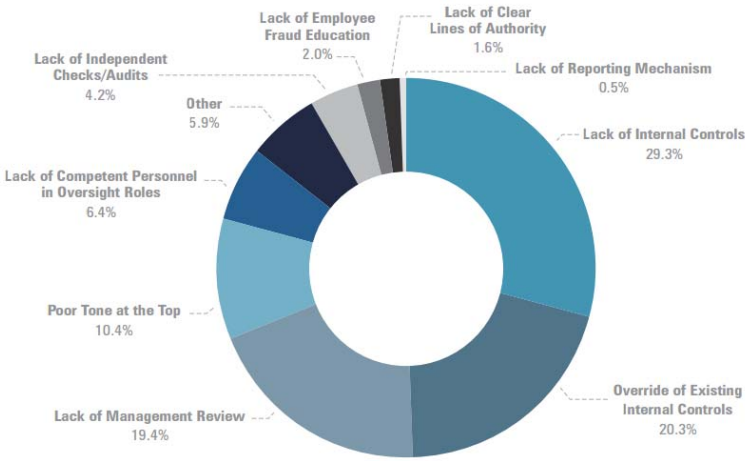
Internal Control Weaknesses that Contributed to Fraud



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Internal Controls

"Often a traffic signal is placed at an intersection only after one or more serious accidents have already taken place there. So too, it is common for internal control to be updated only in the wake of a major control failure."

– *GAAFR Blue Book pg. 739*

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Internal Controls

"It is not possible to meaningfully assess the adequacy of controls without obtaining an understanding of the risks they have to mitigate."

– *GAAFR Blue Book pg. 739*

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Materiality Considerations

- Quantitative materiality
- Qualitative materiality

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Qualitative Materiality

- Entity reputation
  - Tax or fee increases
  - Fund raising
  - Appropriations
- Impact entity's ability to achieve mission

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Qualitative Materiality

"We have felt such a serious impact from the fraudulent transactions identified and realize that these matters extend beyond the individual perpetrating the fraud into the public trust with our entire system."

– Commission response to audit

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Qualitative Materiality

"…in audits performed in accordance with GAGAS, auditors may find it appropriate to use lower materiality levels as compared with the materiality levels used in non-GAGAS audits because of the public accountability of government entities …, and the visibility and sensitivity of government programs.

– GAO 4.47

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Recent Frauds

- Independent State Entity
- County Treasurer
- State Entity
- Irrigation District
- Justice Court

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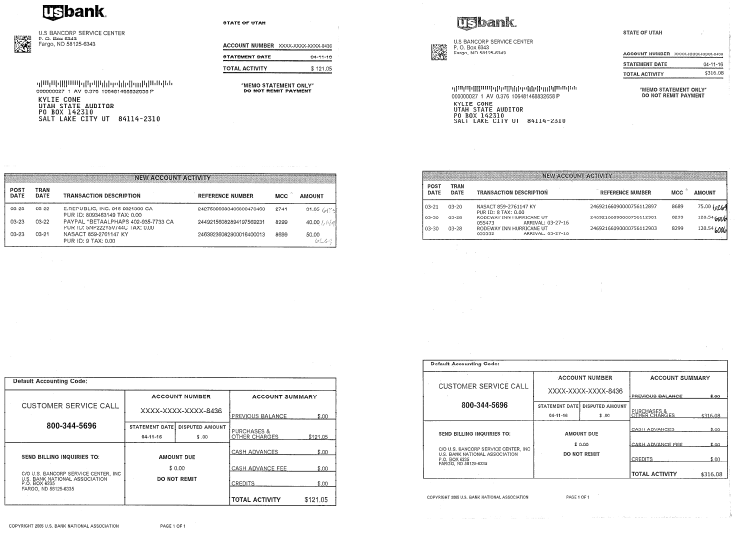
Real or Fake?



usbank

U.S BANCORP SERVICE CENTER
P. O. Box 6343
Fargo, ND 58125-6343

000000027 1 AV 0.376 106481468832658 P
KYLIE CONE
UTAH STATE AUDITOR
PO BOX 142310
SALT LAKE CITY UT 84114-2310

STATE OF UTAH

ACCOUNT NUMBER	XXXX-XXXX-XXXX-8436
STATEMENT DATE	04-11-16
TOTAL ACTIVITY	$ 121.05

"MEMO STATEMENT ONLY"
DO NOT REMIT PAYMENT

NEW ACCOUNT ACTIVITY

POST DATE	TRAN DATE	TRANSACTION DESCRIPTION	REFERENCE NUMBER	MCC	AMOUNT
03-23	03-22	E.REPUBLIC, INC. 916-9321300 CA PUR ID: 8093463149 TAX: 0.00	24275396083406800479460	2741	31.05
03-23	03-22	PAYPAL *BETAALPHAPS 402-935-7733 CA PUR ID: 5NP222Y5V744C TAX: 0.00	24492156082894197569231	8299	40.00
03-23	03-21	NASACT 859-2761147 KY PUR ID: 9 TAX: 0.00	24639236082900016400013	8699	50.00

Default Accounting Code:

CUSTOMER SERVICE CALL	ACCOUNT NUMBER		ACCOUNT SUMMARY	
800-344-5696	XXXX-XXXX-XXXX-8436		PREVIOUS BALANCE	$.00
	STATEMENT DATE	DISPUTED AMOUNT	PURCHASES & OTHER CHARGES	$121.05
	04-11-16	$ .00	CASH ADVANCES	$.00
SEND BILLING INQUIRIES TO: C/O U.S. BANCORP SERVICE CENTER, INC U.S. BANK NATIONAL ASSOCIATION P.O. BOX 6343 FARGO, ND 58125-6343	AMOUNT DUE $ 0.00 DO NOT REMIT		CASH ADVANCE FEE	$.00
			CREDITS	$.00
			TOTAL ACTIVITY	$121.05

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ACCOUNT NUMBER	XXXX-XXXX-XXXX-8436
STATEMENT DATE	04-11-16
TOTAL ACTIVITY	$316.08

"MEMO STATEMENT ONLY"
DO NOT REMIT PAYMENT

NEW ACCOUNT ACTIVITY

POST DATE	TRAN DATE	TRANSACTION DESCRIPTION	REFERENCE NUMBER	MCC	AMOUNT
03-21	03-20	NASACT 859-2761147 KY PUR ID: 9 TAX: 0.00	24692164690000756112807	8699	75.00
03-20	03-20	RODEWAY INN HURRICANE UT 000473 ARRIVAL: 03-27-16	24692160890000756112901	0839	108.04
03-20	03-20	RODEWAY INN HURRICANE UT 000393 ARRIVAL: 03-07-16	24692164690000756112903	8299	128.04

Default Accounting Code:

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800-344-5696	XXXX-XXXX-XXXX-8436		PREVIOUS BALANCE	$.00
	STATEMENT DATE	DISPUTED AMOUNT	PURCHASES & OTHER CHARGES	$316.08
	04-11-16	$ .00	CASH ADVANCES	$.00
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NEW ACCOUNT ACTIVITY

POST DATE	TRAN DATE	TRANSACTION DESCRIPTION	REFERENCE NUMBER	MCC	AMOUNT
03-21	03-20	NASACT 859-2761147 KY PUR ID: 8 TAX: 0.00	24692166090000756112897	8689	75.00 6266
03-30	03-28	RODEWAY INN HURRICANE UT 055473 ARRIVAL: 03-27-16	24692166090000756112901	8299	120.54 6006
03-30	03-28	RODEWAY INN HURRICANE UT 055532 ARRIVAL: 03-27-16	24692166090000756112903	8299	120.54 6006

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Real

			TOTAL XXXX XXXX 0200 0073 $11,347.78	
06/03	06/03	24445004S8PT79N7P	SMITHS FOOD #4047 SANDY UT MCC: 5411 MERCHANT ZIP: 84093	104.94
06/04	06/04	24046034V003RVFZY	CHEVRON 00203669 SANDY UT MCC: 5542 MERCHANT ZIP: 84093	54.00
06/04	06/04	24492154VS0RL8K7Z	PAYPAL *CNSMITH55 402-935-7733 CA MCC: 8999 MERCHANT ZIP: 95131	6,574.85
06/06	06/06	24492154XMHFEZ94S	SQ *CASSI MIGLIORIN SOUTH JORDAN UT MCC: 7230 MERCHANT ZIP: 84095	175.00
06/16	06/16	24692165800NWV0TW	STATE LIQUOR STORE 26 TAYLORSVILLE UT MCC: 5921 MERCHANT ZIP: 84118	259.26
06/17	06/17	742472859PVT9VRGX	T - WWW.TEALEAVES.COM VANCOUVER CD MCC: 5499 MERCHANT ZIP:	158.00

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Fake

06/03	06/03	24445004S8PT79N7P	TEXACO 00351880 PARK CITY UT	104.94
06/04	06/04	24046034V003RVFZY	CHEVRON 00203669 SANDY UT	54.00
06/04	06/04	24492154VS0RL8K7Z	SMITH POWER PRODUCTS 1 SALT LAKE CIT UT	2,236.07
06/06	06/06	24492154XMHFEZ94S	PAYPAL EBAY MARKTPLC USD 402-935-7733 NE	175.00
06/16	06/16	24692165800NWV0TW	THETELECOMSPOT.COM 972-334-9622 TX	759.26
06/17	06/17	742472859PVT9VRGX	PAYPAL EBAY MARKTPLC USD 402-935-7733 NE	158.00
06/17	06/17	24387755903VKWRMV	GRAYBAR ELECTRIC 314-573-9200 MO	360.95
06/20	06/20	24013395B01WNLXPT	MAVERIK #420 WEST VALLEY UT	84.00
06/30	06/30	24492155MS19KQFGV	ACTION BATTERY WHOLESALER715-2475512 WI	3,576.78

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Missing Receipt Log

STATEMENT for June 2015

Receipts Missing - Lost and/or Not Given

Date	Company Name	Amount	Reason L or NG	Signature
6-3-15	Texaco	$104.94		
6-4-15	Smith Power Products	$2236.07		
6-6-15	PayPal Ebay marktplc USD	$175.00		
6-16-15	THETELECOMSPOT.com	$759.26		
6-17-15	PayPal Ebay marktplc USD	$158.00		
6-17-15	Graybar Electric	$360.95		

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County Treasurer

- Bank transfers to personal accounts – $34,600
- Missing cash receipts – $56,182

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Transfers

Screenshot of Bank Statement

Date	Deposits	Withdrawals	Activity Description
10/06		500.00	XFR from xxx8122 to xxx5705
10/16		10.00	DEBIT MEMO
10/24		2,000.00	XFR from xxx8122 to xxx4046
10/24		15,000.00	XFR from xxx8122 to xxx5316
10/30		2,000.00	XFR from xxx8122 to xxx4046
10/31		400.00	XFR from xxx8122 to xxx5705

Highlighted transfers are those from the county bank account to a personal account.

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Cash Receipts

County Cash Receipt Report

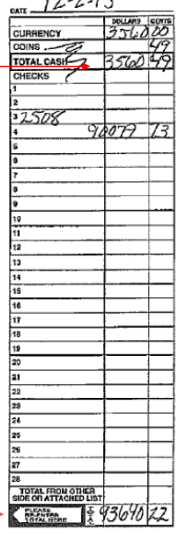
Deposit Totals

Payment Type	Actual Total
Cash	$5,900.49
ACH	$0.00
Check	$90,079.73
Money Order	$0.00
Total Deposit	$95,980.22

Does cash collected balance?

Does total received balance?

Validated Deposit Slip



$3,560.49

$93,640.22

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Separation of Duties

- Ideally, the following should be separated:

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Solution

- Separate
  - Access to Cash from
  - Bank Reconciliation and
  - Reconcile Original Receipt Record to Validated Deposit Slip
- Secondary Review of Adjustments
- Others?

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Separation of Duties

- When an entity has a small number of staff and each responsibility above cannot be separated, weaknesses can be mitigated by a secondary review or approval.

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Broader Challenges

- Law defines responsibilities of elected offices.
- Treasurer
  - receive all money belonging to the county,
  - deposit and invest all money received,
  - keep a record or receipts and expenditures
  - disburse county money

– *Utah Code 17-24-1*

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County Legislative Body

- "Each county legislative body shall, with the advice and assistance of the county auditor and county treasurer implement an internal control structure to ensure…" that county funds are properly safeguarded.

– *Utah Code* 17-36-45

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Fraud Happens?

- Who is responsible?
  - Perpetrator

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Who is Responsible for Preventing Fraud

- Internal Finance Professional/Manager
- Governing Body
- Independent Auditor
- Does it depend upon perspective?
  - Public vs. Internal?
- Others pay the price too

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Possible Improvements

Entity

- Expectation Gap – understanding role of audit vs. role of governing body and management
- Audit Committees – more effective use

Independent Audit

- Improved understanding of the design and implementation of internal control
- Improved communication of weaknesses

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Governing Body Training

- Refer clients to on-line training or ask if they have participated in training
- Help reinforce concepts and roles

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Financial Statement Audit Expectation Gap

- Means:
  - Amounts materially correct
  - Amounts stated in accordance with specified standards
- Does not mean:
  - Non-material theft will be found
  - Entity is in good financial health

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Governing with Audit Committees

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Roles

- Governing Body
  - Set policies and procedures
  - Direct & oversee management (ensure management fulfills obligations)
  - Utilize auditors to provide independent feedback
- Management
  - Oversee operations, financial reporting, internal control, & compliance
- Auditor (internal/external)
  - Provide an independent assessment of operations
  - Attest to the reliability of management assertions

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Now That We Understand Roles

- What is the risk of having management:
  - Appoint
  - Compensate
  - Retain
  - Oversee work
  - Evaluate performance

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Possible Financial Statement Audit Improvements

- Internal control work
- Communication of findings

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Improved Communication

Segregation of Duties Finding:

During the course of our audit, we found that the proper segregation of duties does not exist to provide for a proper internal control structure. Inherent staff limitations placed on small Cities make it difficult to provide for these separations in a cost effective manner.

Recommendation:

We recommend that, when feasible, the City provide for proper segregation of duties. However, because in so many instances it is not feasible to provide for these separations, the City Council should continue to constantly be aware of the need for administrative review of transactions and activities of the City.

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Improved Communication

- Finding is generic and seems apologetic
  - Who (use title not name) and what is the weakness?
    - The County Treasurer has access to cash and checks received, the ability to adjust the accounting records, and reconciles the bank statement.

Why Weak Findings?

- Don't want to deliver bad news?
- Not sure exactly where the weaknesses are, but a generic finding covers the firm in case something bad happens?
- Auditor reports to management rather than governing board or audit committee and management may not retain auditor?

Elements of a Finding

- Condition – *the situation that exists*
- Criteria – *what is required or desired*
- Cause – *why did it happen*
- Effect – *where's the hurt*
- Recommendation – *how to fix it*
  - *Yellow Book* 4.10 – 4.14

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Condition

- *The situation that exists*
  - Ensure problem is clearly stated
  - Quantify if possible to show the extent of the problem
    - 13 out of 36 credit card charges reviewed did not have corresponding receipts.

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Condition

The situation that exists --

The county commission has not established appropriate internal controls by segregating certain duties. Specifically, the County Treasurer can authorize a bank transfer, access the funds in the bank account, reconcile the bank account, and conceal errors and potential misappropriations identified in the reconciliation by adjusting the accounting records.

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Criteria

- The standards against which the *condition* is evaluated.
  - Financial Audit – GAAP
  - Compliance Audit – Law, Regulation, Grant Agreement, etc.
- Describes the ideal or preferred *condition*.

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Criteria

- Places to Look
  - Laws and regulations
  - Policies and procedures
  - Contract or Grant Terms
  - Internal Control Documentation
  - Industry data, measures, and trends

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Criteria

What is required or desired --

Utah Code 17-36-45 requires that, "Each county legislative body shall, with the advice and assistance of the county auditor and county treasurer implement and internal control structure to ensure…" that county funds are properly safeguarded. Ideally, the following functions should be separated, authorization, custody of assets, record keeping, and reconciliation. When it is not possible to appropriately separate responsibilities due to a limited number of staff, risks related to some conflicting duties can be mitigated by a secondary review, approval, or reconciliation.

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Criteria

Weak Criteria

- Good business practice is…
- Prudence dictates…
- Proper oversight would…
- A good manager would…
- Any idiot would know…

Strong Criteria

- *GASB* 68 paragraph 16 requires…
- *Utah Code* 51-2a-201 requires…
- Policy #722 requires that…

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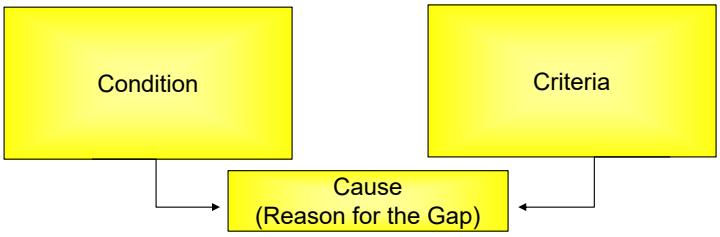
Cause

- *Why did it happen?*
  - The reason for the GAP between the *condition* and *criteria.*



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Cause

- Potential Causes
  - Cluelessness – The grant accountant was not aware that they were supposed to be doing something.
  - Laziness – The grant accountant didn't feel it was necessary
  - Auditor can't say clueless or lazy – This can be difficult to identify

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Cause

- Potential Causes
  - Poorly designed policies, procedures or criteria
  - Inconsistent, incomplete, or incorrect implementation

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Potential Causes

- Failure to enforce policy
- Lack of authority
- Lack of qualification
- Lack of information
- Complexity of control
- Lack of training
- Conflict avoidance
- Loyalty conflict
- Insufficient time to perform control
- Trust (Blind and Willful)

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Cause

- Ask the client to identify the cause or to verify the cause you have identified.
- Identify the "root cause" rather than "symptoms"

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Cause – Symptom vs. Root

Condition

- Duties not property separated.
  - Treasurer could authorize a bank transfer, reconciled the bank account, and could conceal misappropriated by making adjustments to the accounting records.
- Why duties were not properly separated?

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Cause – Symptom vs. Root

- The County Auditor did not exercise oversight of the Treasurer as provided in the law and therefore, did not identify the control weaknesses.
- Why did the County Auditor not exercise oversight?

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Cause – Symptom vs. Root

- As a separately elected official, the Treasurer refused to provide the County Auditor access to accounting records that would have allowed for oversight as outlined in the law.
- Why didn't the County Auditor insist on access to records as outlined in the law?

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Cause – Symptom vs. Root

- The Commission did not support the County Auditor's authority to have access to certain records in the Treasurer's office.
- Why didn't the Commission support the County Auditor's authority to access records?

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Cause – Symptom vs. Root

- The Commission did not believe they had the legal authority to compel a separately elected official to do something and were unaware of their responsibility to implement an internal control structure to ensure that county funds were safeguarded.
- Why was the Commission unaware of their authority and responsibility?

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Cause – Symptom vs. Root

- The Commission believed that the annual financial statement audit would identify fraud.
- The Commission believed they were not financial experts and relied/trusted on the Treasurer and County Auditor to take care of financial matters.

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Cause Statements

- What do you do when you don't have enough evidence to support a "cause" statement?
- What do you do when you don't want to call the client "clueless, lazy" or some other offensive term?

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Cause

Why did it happen --

The Treasures duties were not appropriately separated because the county commission and auditor were unaware for their authority and responsibility implement internal controls over all financial activity regardless of whether the financial activity occurs in a separately elected official's office.

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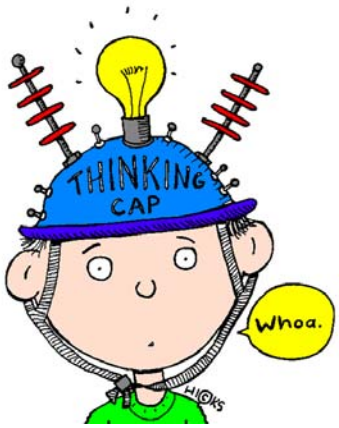
Cause

- *Why did it happen?*
  - Small staff made it difficult to properly separate responsibilities?



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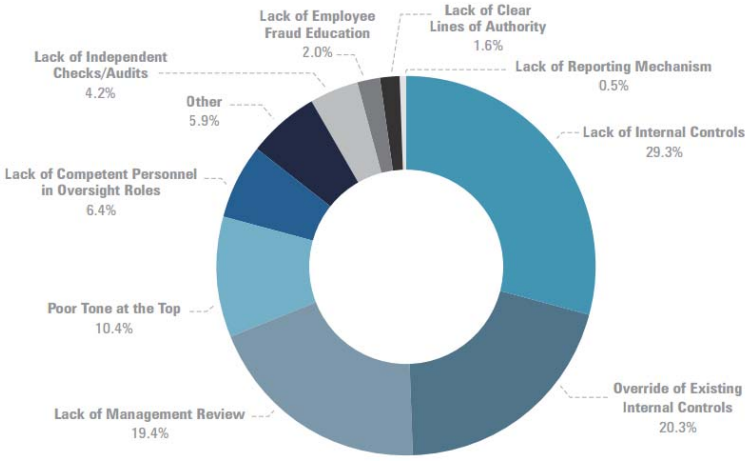
Internal Control Weaknesses that Contributed to Fraud



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Effect

- *Where's the hurt (real or potential)?*
  - The significance or materiality of the finding is usually judged by the *effect.*
  - The actual or potential result of the GAP between *condition* and *criteria*.
  - The *effect* or *so what* state in specific terms – quantifiable if possible, such as loss of dollars, time, or productivity.

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Effect

- *Where's the hurt (real or potential)?*
  - The County Treasurer has the ability to take cash or checks received and conceal the misappropriation identified in the bank reconciliation by adjusting the accounting records.

or

  - $56,182 in cash receipts are unaccounted for.

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Recommendation

- The *recommendation* should discuss in detail the remedy and specify who or what entity is responsibly for taking the action.
- Eliminates the cause
- Calls for action

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Recommendation

- *How to fix – what administrative action should be taken to correct weakness?*
  - Separate the Treasurer's conflicting duties or implement compensating controls such as secondary reviews.

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Improved Communication

Segregation of Duties Finding:

During the course of our audit, we found that the proper segregation of duties does not exist to provide for a proper internal control structure. Inherent staff limitations placed on small Cities make it difficult to provide for these separations in a cost effective manner.

Recommendation:

We recommend that, when feasible, the City provide for proper segregation of duties. However, because in so many instances it is not feasible to provide for these separations, the City Council should continue to constantly be aware of the need for administrative review of transactions and activities of the City.

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Condition

The county commission has not established appropriate internal controls by segregating certain duties. Specifically, the County Treasurer can authorize a bank transfer, access the funds in the bank account, reconcile the bank account, and conceal errors and potential misappropriations identified in the reconciliation by adjusting the accounting records.

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Criteria

Utah Code 17-36-45 requires that, "Each county legislative body shall, with the advice and assistance of the county auditor and county treasurer implement and internal control structure to ensure…" that county funds are properly safeguarded. Ideally, the following functions should be separated, authorization, custody of assets, record keeping, and reconciliation. When it is not possible to appropriately separate responsibilities due to a limited number of staff, risks related to some conflicting duties can be mitigated by a secondary review, approval, or reconciliation.

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Cause

The Treasures duties were not appropriately separated because the county commission and auditor were unaware for their authority and responsibility implement internal controls over all financial activity regardless of whether the financial activity occurs in a separately elected official's office.

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Effect

Because the Commission, County Auditor, and Treasurer did not ensure that internal controls were in place, including … separating certain responsibilities within the Treasurer's Office, $90,782 of County funds have likely been mismanaged, misappropriated, or misused.

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Recommendation

We recommend that the Commission work with the County Auditor and newly appointed Treasurer to establish internal controls that ensure County funds are appropriately used and accounted for. Specifically, the Treasurers duties of authorization, custody of assets, record keeping, and reconciliation should be separated or these conflicting responsibilities should be mitigated by establishing a secondary review, approval, or reconciliation.

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