

July 11, 2014

Honorable Mayor Todd Meier
and Members of the Town Council
Town of Addison, Texas
5300 Belt Line Road
Dallas, Texas 75254-7606

INTRODUCTION

Pursuant to Addendum #1 to our Engagement Letter dated April 23, 2014, we are submitting this First Set of Recommendations regarding the operations, policies, procedures and internal controls over the Town's accounting and finance functions. This First Set of Recommendations is being provided as a guide and is not intended to provide all of the details associated with the implementation of each recommendation. The footnotes are an integral part of this report and should be carefully reviewed.

It is important to note that our work is ongoing in several areas such as procurement cards, inventory accounting, interfund activities, special events and account reconciliations, to name a few. We expect to have further recommendations in the coming weeks. We are happy to discuss each individual recommendation in depth, answer any questions, address any concerns and, of course, stand ready to assist you and the Town's staff in any way we can.

EXECUTIVE SUMMARY

Based on information we have gleaned during our interviews with Town staff, it appears that beginning in roughly 2009 the then Town Manager made a decision to significantly reduce the staffing in the Town's Finance Department (including purchasing). Although we have not studied the structure of, and procedures in the Finance Department on a historical basis, it is clear that the current staffing, experience and training levels in the Finance Department are inadequate. These inadequacies make the Town vulnerable to experiencing instances of fraud, waste and/or misapplication of assets. Further, these deficiencies also mean that it would be difficult for the Town to detect instances of fraud, waste and/or misapplication of assets should they be occurring.

The current staff appears to be working effectively to the best of their abilities, prior experiences and training. However, most of the staff that does exist in the Finance Department are either clerical or have limited professional experiences. The result of this lack of sufficient qualified staff in the Finance Department has resulted in a defacto delegation of certain accounting and internal control functions to the various departments. Unfortunately, the Town's departments have no CPA's or other trained accounting personnel to competently institute uniform accounting processes or perform accounting functions.

Accordingly, each department has instituted their own processes for performing accounting related tasks, most of which do not document an appropriate level of internal control over purchasing, receiving, disbursement and asset tracking. For example, when department level personnel were asked about the lack of documentation accompanying invoices submitted for payment (i.e. packing lists, receiving reports, receiving employee's name, confirmation of quantity received, etc.) the responses given were typically "the proof that everything was correct was that the invoice was forwarded to Accounts Payable for payment" or that "of course we received what we ordered – I would not have sent the invoice in otherwise".

The detrimental effect of the lack of adequate experienced Finance Department staff has also resulted in many key accounting procedures simply not being performed such as accounting for the purchase of fixed assets, performing physical inventories, reconciliation of physical inventories to the Town's accounting records, and updating the Town's banking authorizations to remove long departed employees from the Town's wiring authorizations.

Additionally, the Town's processing of payroll was reportedly moved to the Human Resources Department an unknown number of years ago. The Town's payroll processing is performed by a Human Resources ("HR") Department employee who, among other things: a.) Accesses the Town's Employee Master File, b.) Sets-up employee paychecks, and c.) Singularly, authorizes the disbursement of funds from the Town's payroll bank account. This results in a significant concentration of duties. Both the Town's Chief Financial Officer ("CFO") and the Vice President assigned by the bank to manage its relationship with the Town were unaware that the HR employee was initiating and authorizing the bank to fund payroll using a bank FTP site that was not understood to even exist.

Management Response

Management generally agrees with the recommendations provided in this report. Immediate action has been taken to improve controls for wires and ACH payments, for payroll, and for accounts payable. More detail is provided below. Further, the CFO is working with Gradient Solutions to develop a comprehensive implementation plan responding to the recommendations. In fact, Gradient worked with us this week to do walk through reviews of accounts payable, cash receipts, wires and ACH payments, municipal court cash handling and record keeping, and payroll.

Management is appreciative of this opportunity to review the financial operations of the organization. While we generally agree with the provided recommendations, we will also evaluate the cost-benefit of these recommendations as they relate to the various processes. Throughout this process we will make sure our recommendations are those of best practice, yet feasible to the organization.

We expect the plan to be completed in September. However, implementation of the recommendations will take time and financial investment. The City Manager and CFO will share the plan with the Council and will provide periodic updates on the progress of the implementation.

PURCHASING, PROCUREMENT & ACCOUNTS PAYABLE PROCESSING

Recommendations

- Accounts Payable Processing – a new policy should be issued and enforced. Among other things, the policy should require all invoices submitted for payment be accompanied by the following:

- a) A packing list from the vendor;
- b) A notation on the packing list by the receiving employee that includes the name of the employee receiving the goods or service, the date the good or service was received, a confirmation of the quantity received, a confirmation that the goods or services received matched what was ordered with any exceptions explicitly noted on the packing list;
- c) Alternatively, if the vendor did not provide a packing list, the Town should make available to all employees a receiving report form that can be used in lieu of a packing list;
- d) All invoices and receiving documents should be matched to the Purchase Order (“PO”) and verified as to price, quantity and product description, with any exceptions properly resolved prior to payment by accounts payable.

- Procurement – a new policy should be issued and enforced that requires all purchases be made on a PO (except for those specifically permitted on a procurement card). The use of Payment Authorization Memorandums (PAMs) should be restricted to cases of extreme emergency. This new policy should require:

- a) All vendors be vetted and pre-approved by the Purchasing Agent;
- b) One of the five permitted types of POs be completed at the beginning of the purchasing cycle (or at the beginning of the fiscal year);
- c) Amounts exceeding the original amount authorized on the PO be approved at the appropriate levels;
- d) Purchases made via Interlocal Agreement should be shopped by the Purchasing Agent to ensure that the Interlocal Agreement with the best pricing is being utilized.

This policy change will require that all known recurring vendors currently being paid with a PAM or a procurement card be set up on a PO, consequently a ramp-up period will be required. We believe that the necessary preliminary steps can be undertaken so that this policy can be implemented and enforced as of the beginning of the new fiscal year (October 1, 2014).

Basis for Recommendations

Our analysis determined that there are significant deficiencies in the Town’s Purchase and Cash Disbursement System, which need immediate remediation. The Town is at significant risk for theft, fraud and/or misapplication of assets.

In fiscal year 2011 and 2012, the Town’s auditors, Weaver, in their Federal Single Audit Reports noted a “Significant deficiency in internal controls over financial reporting” in the Purchase and Cash Disbursement System.

Specifically, Weaver, in their FY 2012 Federal Single Audit Report noted:

Finding 12-02 Purchase and Cash Disbursement System

Type of Finding: Significant deficiency in internal control over financial reporting

Questioned Cost: Not Applicable

CRITERIA OR SPECIFIC REQUIREMENT:

Purchases made and disbursements processed where Town purchasing procedures were not followed.

CONDITION:

Purchasing and disbursement processing procedures were not consistently followed.

- Purchase orders created after goods/services ordered or received.
- Check requiring dual signatures did not have required signature.

CAUSE:

Town purchasing policies are not enforced.

EFFECT:

Purchase orders are created after goods and services are ordered.

RECOMMENDATIONS:

We recommend management review the Town's purchase and cash disbursement policies and implement a purchase and cash disbursement system and policy that will allow for controls to be in place as intended.

This issue was not included in Weaver's FY 2013 Federal Single Audit Report but it was included in their FY 2013 Management Letter. During our interviews, it was noted that although there are reportedly fewer occurrences of POs being created after goods are received, a form known as a "Purchase Acquisition Memo" ("PAM") is being used instead of a PO. The PAM is a form prepared by the department making the purchase and is usually prepared at the time the invoice is being sent to the Accounts Payable clerk for payment. It appears that the remedy adopted to resolve the deficiency noted by Weaver was to simply stop using PO's. The PAM is not a suitable substitute for a PO¹.

¹ Purchase orders ("PO") are generally considered to be beneficial to an entity's internal control environment. Among other things, the PO:

- Ensures that budgeted funds are available and encumbered prior to incurring a liability;
- Ensures that budgeted funds are available and encumbered prior to incurring a liability;
- Allows the department head to approve the expenditure of funds for a specific product before they are expended, at an agreed price and quantity;
- Allows management to gain a more complete picture of the purchases planned for the year;
- Increases purchasing efficiency by forecasting routine recurring purchases at the beginning of the year;
- Allows for the comparison of the quantity requisitioned to the quantity actually received;
- Allows for the comparison of the price of the goods requisitioned to the price actually appearing on the invoice;
- Assists with the detection of duplicate invoicing by vendors.

In addition to the use of PAM forms in lieu of POs, additional deficiencies noted included little attention being paid to standard documentation and accountability processes typically found in virtually every functioning internal control environment:

- Receiving documents such as packing lists with notations such as circling and initialing quantities received or the use of a receiving form that documents items and quantities received were not found. Accordingly, invoices are paid without documentation that the quantity and type of good actually received matched what was ordered and invoiced;
- Invoices being paid without documentation of the name of the employee actually receiving the good or service (or even if the good or service was actually received);
- Invoices being paid without formal approval documented on the face of the invoice. Best practices dictate that approval by the department head be indicated on the face of the invoice (or electronically in the GEMS² system) prior to its submission for payment;
- Some PAM forms show no evidence of managerial approval other than a rubber stamp of a signature stamped on the PAM form;^{3 4}
- The A/P system does not interface with a fixed asset register. We noted that fixed assets are maintained on an Excel Spreadsheet. Significant risk exists that assets are purchased and are not recorded in the Town's fixed asset register.

Although the Town's Purchasing Manual assigns distinct duties and responsibilities to the Purchasing Agent⁵, it appears the duties actually being performed by the Town's Purchasing Agent are limited to mostly clerical functions such as:

a) Facilitating the bidding process – including maintaining the BidSync system, verification and maintenance of a bidder's insurance and maintenance of bid files and contracts;

b) P-Card set-up;

² GEMS is an Enterprise Resource Management system from Harris Computer Systems Inc. According to the Harris website, GEMS Financial, Payroll, Human Resources and Utility Billing solution has been serving hundreds of customers across 33 states since 1983.

³ Our procedures did not include testing of transactions. However, we observed a transaction where ammunition was purchased without a PO. There were no documented approvals on the vendor's invoice, no receiving documents, no confirmation of the quantities and price and no indication that the ammunition was logged in to an inventory system. In addition, the PAM form included no authorization except that of a rubber-stamped signature of the police chief.

⁴ Numerous examples of PAM forms being used in place of POs were observed without clear indications that the purchases were authorized and made in accordance with the bid requirement of the Town's Purchasing Manual.

⁵ The Town's Purchasing Manual states, in part that:
"A.the Purchasing Agent [has] the authority to procure all goods and services and dispose of all salvage/surplus and seized property for any department or any using agency that derives its support wholly or in part from the City. The Purchasing Agent shall administer the purchasing rules and regulations as established by Texas State and Local Government Codes.

B. Purchasing Agent – The Purchasing Agent performs or oversees compliance with all procurement requirements for goods and services as prescribed in the Texas Local Government Code, and the City Policy and Procedure. The Purchasing Agent ensures that all procurement activities are conducted with the highest level of ethical standards, provide suppliers a fair opportunity to compete for City business and protect public funds."

c) Facilitating the disposal of surplus assets.

The Town's Purchasing Agent is not performing the duties assigned in the Town's Purchasing Manual because she does not have the proper training or experience. At time of our original interviews, the Purchasing Agent had no formal training in the purchasing rules and regulations promulgated in the Texas State and Local Government Codes and did not view her role as one of monitoring compliance in any area except for the bidding process. Subsequently, we understand that the Purchasing Agent has completed one training class.

Management Responses:

Management generally agrees with the recommendations provided in this section. The Town currently has a decentralized purchasing process, due in large part to volume and staffing levels. Also, the Town contracted with Carol Cooper of N & C Consulting to train staff and craft a policy providing best practices with the resources that were available. We realize that there is an opportunity to improve the use of Purchase Orders throughout the organization, and currently we are in the process of evaluating and developing an approach that can be implemented and is also effective for the organization. However, this will not completely remove the need for Payment Authorization Memos (PAM's).

Additionally, vendor set up and approval will now be the responsibility of the purchasing agent. The Purchasing Agent, rather than accounts payable, will be responsible for verifying that vendor information is accurate and that a completed W-9 is provided. Purchasing will also verify the vendor Tax Identification Number (TIN) with the IRS and validate vendor HUB eligibility, if appropriate. Once the required steps are taken, Purchasing will approve the authorized vendor.

In the future, Purchasing Agent will shop between Interlocal Agreements in order to ensure that the best value is being found for similar products and services. This shopping will be done through BidSync, a digital resource that allows rapid and efficient searches of Interlocals.

BANKING

Recommendations

- Banking – the Town currently disburses funds through various account access points. We suggest that the Town inform the Bank to cancel, reassign and reauthorize all currently authorized account access points and streamline the access points into just two points of access. This entails cancelling the Human Resources Department's Payroll Account FTP⁶ access point and the call-in wire

⁶ FTP allows a part-time employee of the HR department to use a user id and password followed up with a fax to the bank to singularly fund payroll. Frost Bank could produce no records or documentation where the Town authorized this FTP access point.

access point. The only two access points should be checks and the bank's electronic Cash Manager System. All other access points should be terminated.

In addition, we suggest that all privileges and tokens that currently exist in the bank's electronic Cash Manager System be revoked and reassigned based on authorities and permissions consistent with proper segregation of duties.

Basis for Recommendations

In connection with our interviews, we requested information from Frost Bank regarding the persons authorized to disburse funds on behalf of the Town as well as the limits to each person's authority. We also inquired as to whether dual signatories, wire security codes and wire callbacks were required.

The responses that were received from Frost Bank were confusing and contradictory⁷. Eventually it was determined that prior to our inquiries, a single check signer could sign a check in any amount, as dual signatures were not required⁸. In addition, we noted that authorized individuals were permitted to access a call-in wire service. However, the individuals authorized to perform call-in wires had not been active employees of the Town for several years⁹. Also noted were significant deficiencies in internal controls over wiring authorities, including employees having the authority to initiate wires in any amount and giving virtually every member of the Finance Department staff the permission to initiate and/or approve wire transfers in the Cash Manager System¹⁰. This broad access to wiring authority gives employees who could make general ledger entries and perform bank account reconciliations the ability to also initiate and/or approve wire transfers in the Cash Manager System. This is a significant internal control weakness. In addition, we noted that six account access validation tokens were reported by the Bank to be issued to the Town but not assigned to a user.

It should be noted that Weaver, in their FY 2012 Federal Single Audit Report noted that certain checks did not have dual signatures as required by the Town's Policies.

⁷ Multiple e-mails were received from Frost Bank, each with different authorized check and/or wire signers and confusion as to whether dual signatures were or were not required in the past. As a result of the confusing responses, an in-person meeting was subsequently held with representatives of KFF LLC, Frost Bank, the Town Manager and the Town CFO. The Frost Bank representative was not able to satisfactorily address the questions regarding account access privileges and promised to do further research. After multiple conference calls and e-mails, it was determined that another account access point existed that the Bank was not aware of until raised by a representative of KFF, LLC. This access point is the FTP access point discussed above.

⁸ Because of Bank automation, the effectiveness of signatures as a control has been greatly diminished. However, we believe the Town should still be on record with the Bank requiring dual signatures of authorized individuals.

⁹ The Bank was asked to search their records to determine if these former employees had performed wire transfers. The Bank reported that no wires from the call-in wire access point had been processed by the departed employees.

¹⁰ Currently, the Cash Manager account administrator privileges are assigned to the CFO. The CFO has established dual control over Cash Manager wires where 2 employees are required in order for a wire to be sent.

Management Response

Management generally agrees with the recommendations provided in this section. However, it is important to get the facts correct: the individual responsible for the bank reconciliations does not have and has not in the past had ACH or wire authority to approve transactions. This is an important internal control point. Also, an important control function exists and is referenced in footnote 10 regarding the established dual approval of wires and ACH payments. Several individuals within the Finance Department have level 2 approval authority, but the CFO is the only authorized level 1 approver. In order to process a wire transaction, both a level 1 and a level 2 approval is required. Management recently completed a request for proposal (RFP) for banking consulting services to assist staff in analyzing our bank services proposals for our upcoming RFP. Our contract for banking services with Frost Bank is set to expire at the end of fiscal year 2015.

Additionally, management has canceled both the FTP and the call-in wire functions. Currently, the only means of accessing Town funds is through the "Cash Manager" platform or with an authorized check. Only necessary personnel have access tokens for the Cash Manager system, and all profiles have limited capability based on their job related duties.

PAYROLL

Recommendations

- Payroll Processing – the town currently processes its payroll in the Human Resources Department. We suggest that the Town engage a third party payroll vendor to process the Town's payroll. The marketplace currently has several highly qualified providers who can very efficiently perform all the functions required by the Town in a highly controlled and efficient manner.
- Payroll Administration – we understand that the Town will have to solicit bids for an outsourced payroll provider and the process will likely take some time to complete. As an interim step, we recommend that the payroll processing function currently performed and supervised in the Human Resources Department be immediately moved to the Finance Department and supervised by the Chief Financial Officer.

Basis for Recommendations

Payroll is the Town's biggest recurring expense. Currently, the payroll function is performed in-house by one part time employee.¹¹ The HR record keeping function should be completely separate from the processing of payroll. Currently, there is not a proper segregation of duties. This employee can:

- Add new employees
- Modify current employees pay rate

¹¹ This part-time employee is the wife of a Town Department Head.

- Enter hours worked
- Adjust hours worked
- Adjust vacation accruals
- Code time to vacation, overtime, normal pay
- Set up garnishments
- Prepare payroll tax reports
- Prepare W-2 forms
- Make payroll tax payments
- Set-up Paychecks
- Prepare and send positive pay files to the bank

The payroll function, as it currently exists puts the Town at significant risk in a number of areas. This one employee has access to virtually every aspect of each employee's personal information including social security numbers, bank account numbers, retirement accounts, employee name and addresses, pay rates, garnishments, etc. A great deal of responsibility (and trust) is being placed on one employee. In addition, it does not appear that the work of this one employee is being audited in any way.

Currently, the bank automatically deducts from the Town's operating account every debit that hits the Payroll account, without any oversight from any management level employee.¹²

Many organizations have found that outsourcing the payroll processing function is beneficial because:

- Regulatory Issues– IRS and Department of Labor regulations are constantly changing;
- Segregation of Duties- The people performing the payroll processing have no personal connection with the client's employees;
- Expertise and Accuracy– Payroll processing firms are extremely well versed in the preparation of all payroll related forms and reporting requirements;
- Cost– Many organizations find it cost effective;
- Accountability– When issues arise, many organizations get a sense of comfort in knowing there is an "expert" available who can help deal with the issues that invariably arise.

If payroll is performed in-house, proper segregation of duties in the payroll function entails ensuring that no single employee can access the Employee Master File and process payroll. The Employee Master File should be maintained and modified only as a result of a series of approvals by authorized persons in the Human Resources Department. Persons in the Human Resources Department who are involved in making hiring and termination decisions should not have direct access to the Employee Master File. The reporting of hours worked (for hourly employees) should be administered by the Human Resources Department by an employee who is not authorized to access the Employee Master File. The actual processing of payroll should be a completely separate function that is supervised by the Chief Financial Officer.

Management Response

¹² During our interviews, it was clear that the Chief Financial Officer had no knowledge of how payroll was funded or who was authorizing the funding of the payroll bank account.

Management generally agrees with the recommendations provided in this section. Recently the Town's payroll specialist was moved from HR to Finance, and is under the direct supervision of the CFO. We are in the process of working with HR to establish revised processes and responsibilities, in order to ensure the proper segregation of duties and access to make changes to the employee master file.

The Town now uses Cash Manager, a highly secure website, to process our payroll ACH file. The change provides controls that were not previously a part of the process.

CASH RECEIPTS

Recommendations

- Remittance Processing – contract with a bank to provide lockbox services for the receipt of payments remitted to the Town by mail (similar to the system currently in place for the payment of water bills). This will require that payers mail all payments currently being mailed to the Finance Department directly to the bank for deposit. The bank will then electronically report details of each deposit to the Town for entry into the Town's accounting system.
- Cash Receipts – contract with a bank or other provider to install electronic local cash receipts lockboxes at each of the Town's sites that collect cash and checks at point of sale. These services are referred to by various proprietary names but generally, they provide for the cash and checks that are currently collected at the Town's Courts Building, Conference Center, Athletic Facility and Service Center to be deposited at the end of each business day with the bank, off-site and with immediate account credit. The local cash receipts lockbox would then serviced periodically be an armored car service.

Basis for Recommendations

The Cash Receipts Clerk¹³ receives checks and cash, prepares deposits and makes entries to the GEMS System. The functions of receiving, posting, reconciling and deposit preparation should be separated. The Town also receives monies from a variety of other sources including utility billings¹⁴, court fines, property taxes, conference center fees, airport fees, athletic center fees, special events and a variety of other proceeds from permits, fees and taxes. These monies may be received in the form of credit cards, checks and cash and are received at several different locations.

The current system is highly decentralized in that cash and checks are received at various locations and delivered in "bank bags" to the Cash Receipts Clerk. This process results in the routine transfer of cash and cash equivalents by a Town employee to more than one

¹³ The Cash Receipts Clerk is a recent college graduate and is in need of training.

¹⁴ Utility receipts are routed directly to a dedicated utilities lockbox at the bank.

location before receipt by the bank. Each added physical movement of cash and cash equivalents between locations outside of the bank puts the Town at added risk of loss. It increases the workload of the Cash Receipts Clerk and the Town employee who is acting as the courier.

In addition, two of the four Court Clerks are responsible for aggregating the monies collected each day into a bank deposit and entering the amount of the deposit into the GEMS system. The deposit bags are then handed to the Town's mail courier who then delivers them to the Cash Receipts Clerk at the Finance Department mentioned above.

Management Response

Management agrees with the recommendations provided in this section. These solutions provide great controls for various processes throughout the Town. We are in the process of evaluating the cost and the benefit that these services provide. Communication with Frost Bank is on-going in an attempt to reduce the amount of checks that are mailed directly to the Town. The Town has also received a quote from Loomis, a third party vendor with Frost Bank, to provide a more secure process for our higher volume cash receipts locations.

FIXED ASSETS

Recommendations

- Fixed Asset Accounting - the Town should activate the GEMS accounting system's Fixed Asset Module. After activating the module, all purchases that are above a specified dollar amount or are sensitive in nature (such as weapons) would be automatically added to the GEMS Fixed Asset Module at the time of purchase. As soon as practicable, a vendor should be retained to perform a physical count of all fixed assets currently in the Town's possession. The assets identified in the physical count (not previously recorded) should be recorded in the GEMS Fixed Asset module. The physical count of assets should also be compared to the various MS Excel and department level fixed asset spreadsheets currently in existence in an attempt to locate any missing assets. Going forward, as a matter of policy, fixed assets should be periodically counted and reconciled to the GEMS system.

Basis for Recommendations

The Town does not uniformly track fixed assets. Departments are currently tracking their assets separately, using various methods and with varying degrees of precision. The Finance Department attempts to track the Town's fixed assets using an Excel spreadsheet. In addition, there is no institutional memory of the last time a physical inventory of Town assets was performed, with the results being reconciled to the Town's financial information.

The Town has many sensitive and highly marketable assets such as weapons, ammunition and computers.¹⁵

Without these basic accounting procedures and controls, the Town is at significant risk of misappropriation of assets.

Management Response:

Management generally agrees with the recommendations provided in this section. The Town is currently in the final stages of the RFP process for a new financial system, sometimes called Enterprise Resource Planning (ERP) system. This new system upgrade will provide an enhanced capability to track our fixed assets as well as our inventory. Fixed assets are items with a per-unit cost of greater than \$5,000. Items that do not meet that threshold but are still sensitive in nature should also be tracked in inventory.

The Town's current Fixed Asset system is meant for "capital items," which are items with a minimum per-unit cost of \$5,000. It is management's intention to have all Town assets listed within a fixed asset module of its ERP. The due diligence process and implementation of a fixed asset module within the Town's ERP will take time.

Management intends to contract with an independent third party to review our current fixed assets and inventory detail to ensure that we have the most accurate information possible. Once this has been completed and a decision has been made on the ERP system, that finding will serve as our baseline for the new accounting process.

Finance Department Staffing and Segregation of Duties

Recommendations

- Finance Department Staffing – the staffing in the Finance Department is insufficient to provide for the current workload while maintaining an appropriate level of internal controls. We recommend the hiring of two experienced persons who are Certified Public Accountants to augment the current staff. The two additional professionals will allow for the appropriate segregation of duties and implementation of needed internal controls.
- Segregation of Duties – as soon as practicable, the duties of the current staff in the Finance and Courts Departments should be reassigned to assure that duties, permissions and responsibilities are properly segregated. The process of reassignment of duties is highly dependent on the implementation of the recommendations listed above.

¹⁵The Town maintains an armory for its police force. The responsibility for maintaining an inventory list of weapons and ammunition was split between two police sergeants, one for SWAT weapons and the other for routine policing weapons. The lists were maintained informally on Excel spreadsheets and were stored on each sergeant's "local drive". Based on interviews, it was discovered that the purpose of the inventory lists were to comply with legal requirements such as the tracking of serial numbers. The inventory lists were not maintained for the purpose of accounting controls. Accordingly, there was no tracking of cost or reconciliation to the Town's accounting records. There was no institutional memory of there ever being a physical inventory count of the weapons and ammunition for the purpose of reconciliation to the Town's accounting records.

- Review and re-assign permissions and authorizations to the finance, accounting and human resources related modules within the GEMS system.

Basis for Recommendations

The lack of proper segregation of duties was observed to be a significant deficiency in internal controls in several areas. A significant risk exists that the Town is unnecessarily exposed to the risk of theft or fraud and will not be in a position to prevent or detect misapplication of Town assets. The following observations are being presented by position title. It is important to note that no information has come to our attention that a misapplication of Town assets has actually occurred.

CHIEF FINANCIAL OFFICER POSITION

It appears that the CFO has unlimited GEMS system access to initiate and modify transactions and postings to the General Ledger, Accounts Receivable, Cash Receipts, Accounts Payable and Budget modules (“the financial modules”). In addition, the CFO is an authorized check signer and is authorized to perform wire transfers as a single signatory on all bank accounts for an unlimited amount and is the administrator for assigning authorities and privileges in the Frost Bank Cash Manager System.

The CFO should not have unlimited GEMS access to the financial modules, and move and disburse funds. Currently, the CFO could initiate or edit a variety of events that would permit the misappropriation of assets or the reversing of a liability without detection. While it is not possible to enumerate all of the possible events, the CFO could initiate or change transactions in the system such as setting up a vendor, entering an invoice, voiding an invoice, paying an invoice, changing the address of a vendor or editing a variety of existing transactions. In addition, the CFO could enter Journal Entries to write off assets, adjust asset values or transfer assets. This lack of segregation of duties puts the Town at significant risk of theft, fraud or misappropriation of assets.¹⁶

ACCOUNTS PAYABLE CLERK POSITION

The A/P clerk currently has the ability to¹⁷:

- Set up new vendors in the Vendor Master File, Enter invoices for payment into the A/P system,
- Initiate the writing of checks,
- Transmit the Positive Pay file to the Bank,
- Access the check stock,

¹⁶ In addition to being a signatory on all bank accounts, the CFO is effectively performing the function of a Treasurer in that he is able to move money between operating and investment Funds. The issue of segregation of duties was discussed in depth with the CFO. The CFO agrees that this is a significant issue that should be rectified as soon as practicable. The CFO indicated that the Finance Department is understaffed and underfunded and would welcome the opportunity to delegate the treasury function to another member of management.

¹⁷ The person in this position is also cross-trained to cover for the Cash Receipts clerk as needed.

- Print checks with signatures,
- Mail checks.

The employee with responsibility for modifying the Vendor Master File should not be responsible for entering vendor invoices in the cash disbursement system or have the ability to generate and authorize cash disbursements. Currently, the Accounts Payable Clerk could, in theory, set-up a vendor and pay that vendor without authorization or detection.

The lack of segregation of duties between the person setting up and modifying vendors, entering and posting disbursements to the GEMS system with custody and control over check stock and signature authority coupled with the lack of visible approval of invoices and extensive use of PAM forms puts the Town at extreme risk of fraud, theft or the misapplication of assets and should be remediated immediately.

ACCOUNTANT POSITION

Currently, the person doing the bank and other reconciliations is able to make Journal Entries. A typical compensating control is to require that each Journal Entry be approved by the CFO. Based on interviews, it appears that all Journal Entries require the approval of the CFO but the approval process is performed via the CFO's manual signature on a paper copy of the Journal Entry. Currently, the GEMS system has the capability to require that Journal Entries be approved in the system, but this capability is not being utilized. Not using the GEMS approval process makes it impossible to run computerized reports to monitor the proper approval of Journal Entries. There is a risk that Journal Entries are being made without the CFO's approval.

The person in the accountant position is also authorized to make transfers in the Cash Manager System.

COURT CLERK POSITIONS

Court fines, traffic ticket payments and bonds are currently received by one of four Court Clerks. All four of these individuals maintain a "till" for the purpose of receiving funds and making change to persons paying in person. Each Court Clerk is responsible for balancing their "till" at the end of each day by reconciling the funds in the "till" to the printout from the Infosol court software.¹⁸ Best practices suggest that the person(s) who are able to enter/modify transactions in the Infosol system and collect cash should not be able to perform reconciliation of the "till" to the system.

Best practices require that certain of these tasks be separated. As discussed above, the Town should implement a centralized Lockbox system whereby all cash and cash equivalents are directed to a bank. The duties and system access rights of the four Court Clerks should be immediately modified so that the person responsible for reconciliations is not the same person who accepts monies, has system access and prepares deposits. In

¹⁸ The Courts department uses a software package called Infosol to record activity. This system apparently does not electronically interface with the GEMS system.

addition, the Town should consider moving the person responsible for reconciling and recording Court transactions to the Finance Department.

INFORMATION TECHNOLOGY

A critical component of the internal control environment is the control of access to the Town's GEMS computer system. We noted that employees might have access to modules of the system for which they no longer require access (or should not have access to achieve proper segregation of duties). We also observed the names of former employees who continued to have access rights to certain GEMS Modules even though they were no longer employees of the Town.¹⁹ As the segregation of duties issues are addressed, GEMS systems access rights should be updated.

Management Response

Management agrees with the recommendations provided in this section. As part of our efforts to rebalance and right-size organizational staffing, we have elevated the Accounting Manager position to an Assistant Director in an attempt to attract better talent and become more financially competitive within the market. In addition, we have budgeted funds for a new Senior Accountant position with a CPA license and included funds to bring the administrative position from part time to full time. A revised organization chart is attached for reference.

The increased staffing will enable Finance to accomplish much of the recommended segregation of duties and will accelerate implementation of the work plan mentioned above.

We have asked Gradient Solutions to review our system administration process and evaluate the access available in the financial, payroll, and court systems. This is part of the aforementioned work plan. It will not be feasible to limit the CFO's system access, as recommended, until the additional hiring is accomplished.

Management has taken action to remove vendor file maintenance responsibilities from the person responsible for processing accounts payable. Additional checks and balances have been implemented in accounts payable as part of the review by Gradient Solutions. These are listed on a detailed checklist that is signed by both the preparer and the reviewer to ensure all processes are completed.

SUMMARY COMMENTS

Our recommendations are based primarily on interviews of members of the Town's staff. Limited analysis of documents, along with information obtained from the Town's bank were also factored into our recommendations. Detailed testing of transactions were outside the scope of this engagement. Although other compensating policies, procedures and internal controls may exist, we were unable to identify compensating policies, procedures or internal

¹⁹ We were told that although the names of former employees still have access rights to certain modules of GEMS, the former employees could not actually access the GEMS system because their overall permissions had been withdrawn.

controls that would reliably mitigate the risks associated with the staffing shortages and internal control weaknesses observed.

Our engagement did not involve an audit, review, compilation, Internal Control Review or attest service as those terms are defined by the American Institute of Certified Public Accountants. Further, our procedures were not designed to detect fraud or non-compliance with laws, contracts or regulations nor were they designed to detect the misapplication of assets.