



Financial Accounting Controls

Grant Thornton (GT) COSO Follow-up

City of Charlotte

Committee of Sponsoring Organizations
of the Treadway Commission (COSO)
2013 Internal Control Integrated
Framework
Recommendations Report and Gap
Analysis

Final Report

February 16, 2018

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Financial Accounting Controls Audit

Grant Thornton (GT) COSO Follow-up

Executive Summary

Objective

This audit was conducted to determine whether satisfactory progress has been made in achieving the key recommendations made in Grant Thornton's review of the City's internal controls.

Background

In February 2018, Grant Thornton LLP (Grant Thornton) presented a gap analysis using the 2013 COSO Internal Controls Integrated Framework. One of the report's key takeaways was "...the City of Charlotte's control environment could be improved and enhanced by following the COSO Framework as a best practice."

The COSO Framework consists of 17 principles that fall under five components. Using this Framework, Grant Thornton recommended actions the City should take to strengthen internal controls. Auditors identified nine key recommendations for inclusion in this audit's scope.

Conclusion

Limited progress has been made to address Grant Thornton's most critical recommendations, which can significantly improve City-wide financial accounting internal controls.

Highlights

The City has not fully implemented seven of the nine most critical recommendations from GT's COSO Gap Analysis report.



- Identify Structure, Authority, and Responsibilities of the Internal Control Program
- Conduct an ERP System Post-Implementation Review



- Develop a Code of Conduct and Ethics Training
- Conduct Internal Control Process Improvement Deep-Dives of Business Processes
- Develop and Hold Internal Control Training
- Perform an Enterprise Risk Management (ERM) Risk Assessment
- Determine Monitoring Activities



- Continue and Sophisticate the ERM Pilot
- Document IT System Controls in the System Security Document

Actions Taken and Planned

Finance has recently established a new Financial Internal Controls Division. While the focus of the new division will be documenting controls relating to financial reporting using the COSO framework, the group will also be a resource for other departments. Finance notes that progress toward addressing these critical items, which will significantly improve citywide financial internal control, had been previously constrained by limited staff available to successfully design and implement a COSO compliant citywide internal control program.

HR is reviewing the Allegations of Employee Misconduct Policy to determine if it needs updating. All City employees will be required to complete annual ethics training, starting in October 2021.

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Background

In February 2018, Grant Thornton conducted a gap analysis using the 2013 COSO Internal Controls Integrated Framework under a contract with the Finance Department (Finance) and the City Manager's Office (CMO). One of Grant Thornton's key takeaways was "...the City of Charlotte's control environment could be improved and enhanced by following the COSO Framework as a best practice."

The COSO Framework consists of 17 principles that fall under five components:

- Control Environment
- Risk Assessment
- Control Activities
- Information & Communication
- Monitoring Activities

Grant Thornton, using the COSO Framework, recommended actions that the City should take to strengthen internal controls. In its February 2018 report, Grant Thornton suggested these be implemented in a phased approach so that more important improvements could be prioritized. The report included recommended actions grouped by COSO component (Appendix).

Objective

This audit was conducted to determine whether satisfactory progress has been made in achieving the key recommendations made in the 2018 Grant Thornton report that reviewed the City's internal controls according to the COSO 2013 Integrated Framework.

Scope, Methodology, and Compliance

Scope

Auditors identified the following nine key recommendations from the original Grant Thornton review:

1. Develop a Code of Ethics and ethics training;
2. Develop and hold internal control training;
3. Conduct an ERP system post-implementation review;
4. Identify structure, authority, and responsibilities of the internal control program;
5. Continue and sophisticate the ERM pilot;
6. Perform an ERM risk assessment;
7. Conduct internal control process improvement deep-dives of business processes;
8. Document IT system controls in the system security document; and
9. Determine monitoring activities.

Methodology

To achieve the audit objectives, auditors performed the following:

- Judgmentally selected the recommendations from the Grant Thornton report deemed critical for improvements to the City's internal control environment,
- Interviewed department staff, and
- Reviewed relevant documentation.

Compliance

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Finding and Recommendations

The City has not fully implemented seven of the nine most critical recommendations from GT's COSO Gap Analysis report.

The following provides an implementation status of each key recommendation:

1. Develop a Code of Conduct and Ethics Training



Per Grant Thornton report: Develop a Code of Conduct to guide employees in ethical behavior, activities, and decisions. Management should ensure the Code of Conduct is regularly communicated and reinforced to all levels of the organization. Establish continual and periodic compliance procedures to confirm that expectations and requirements are being met. A Code of Conduct provides the basis for evaluating adherence to integrity and ethical values across the organization. Additionally, requiring staff to take ethics training ensures that staff are continuously aware of expectations.

The City has published a Code of Ethics on CNet, however, it is not a formal City policy. There is a policy titled “Allegations of Employee Misconduct” that does not appear to have been updated since its issuance in 1982. This policy is not published on CNet.

As reported in the Conflict of Interest Investigation audit report (issued October 28, 2020), the Code of Ethics training module exists on the City’s Learning Management System and Human Resources (HR) has made the training a requirement for all new hires. The revised Conflict of Interest policy is currently pending review and approval and will be added to the eLearning platform when finalized.

Recommendation A: HR should update the Allegations of Employee Misconduct Policy (from 1982) and consider incorporating the current Code of Ethics as a part of this policy.

Value Added: Compliance; Risk Reduction

HR Response: A decision has not been formalized by HR to combine the Code of Ethics and the Allegations of Employee Misconduct; however, HR is reviewing this policy to determine the need to update.

Recommendation B: The CMO and HR should require *all* employees to annually complete a City ethics course.

Value Added: Compliance; Risk Reduction

HR Response: HR currently requires all new hires and employees participating in the city’s Supervisor Training, to complete the Ethics Training module. HR will begin requiring all current employees to complete the Ethics Training each year in October 2021. This training will exist as an eLearning module in our current LMS (Learning Management System) and for those employees that experience challenges with access to the eLearning module, it will be available in a paper format for their review and signature.

2. Identify Structure, Authority, and Responsibilities of the Internal Control Program



Per Grant Thornton report: An Internal Control Program is vital to the functioning of any organization so that management has reasonable assurance regarding the achievement of an entity's objectives. The internal control infrastructure is the foundation of an Internal Control Program. The framework would include the structure, authority, and responsibilities for documenting, updating, and testing internal controls across the organization.

In 2018, Finance created a team to review various internal controls/processes throughout the City. Finance has a formal charter in place for the Internal Control Team that adequately outlines their scope of work and their objectives. This Internal Control Team consisted of current Finance Department staff who performed this work on a part-time basis, in addition to their regular job responsibilities. Several members of this team were unable to assist during parts of the year as they were needed to compile the City's annual report.

Action Taken: Finance has created a Financial Internal Controls Division (and recently hired a Division Manager). Several positions from within Finance will be migrated to this new division. This division will be able to better focus their time towards the responsibilities previously performed by the ad-hoc Internal Control Team. The structure, authority and responsibilities of the new division will evolve over time.

3. Conduct Internal Control Process Improvement Deep-Dives of Business Processes



Per Grant Thornton report: Begin to conduct internal controls process improvement deep-dive assessments of selected business processes. This would involve walkthroughs of each process with stakeholders, reviewing any job aids and procedures, inventorying current controls and attributes, providing as-is flow charts and assessment of the control environment and activities, and providing recommendations of changes to remove or add additional controls so that all financial statement assertions are covered.

The Finance Internal Control Team (outlined in the preceding section) performs the work outlined by GT. The Team maintains a work plan of over 30 items. These include the review of various policies, procedures, forms, and process maps (e.g., Capital Asset Policy and the Citywide Signature Authority Form).

The Team has marked 32% of the workplan "complete" and 15% as "in progress." The remaining 53% of identified items are marked as "not started" or "deferred." Although Finance has marked some items as "complete", auditors were not provided evidence indicating that the need for control testing or monitoring had been considered.

Recommendation: Finance should complete the remaining "process improvement deep-dive assessments."

Value Added: Risk Reduction; Efficiency

Finance Response: Agree. However, the Finance Internal Control Division has determined that process improvement deep dive assessments are a component of larger projects that begin with wholesale policy review, revision or development; followed by review, revision or development of related procedures, business processes and required forms/job aids including documentation of updated process maps with internal control points clearly identified. The Finance Internal Control Division is primarily responsible for the corrective action, but participation and collaboration by the policy/process owners, as well as key stakeholder departments is critical to positive, meaningful outcomes. Corrective action for this finding is currently underway as follows:

- a. Projects carried over from Internal Control Team are on-going (Contract Policy Project; Lease Policy Project).
- b. Final draft of Division Strategic Operating Plan is completed and under review by CFO; SOP details background and business drivers, fiscal year objectives, scope of work, mission, operating model, and service portfolio.
- c. Inventory of current Finance policies, processes and procedures is underway to update and prioritize division work plan for FY 2022 and beyond; updated workplan will provide information needed to quantify the body of work, identify stakeholders, assess resources required for each project, establish timelines, and estimate completion dates.
- d. Rate of completion for each project is constrained by the complexity of each project; limited staffing of the Finance Internal Control Division and competing priorities for policy/process owners and stakeholders.

4. Develop and Hold Internal Control Training



Per Grant Thornton report: Develop a training curriculum for internal controls to emphasize the importance of controls and reducing/identifying fraud risks. The training should incorporate best practices and framework requirements (e.g., COSO). The training session(s) will promote an understanding and importance of internal controls and compliance efforts. Additionally, this will further demonstrate the City's commitment and investment to develop, retain, and empower skilled practitioners.

The Finance Internal Control Team developed the new Financial Internal Control policy based on COSO; all departments provided feedback. The policy does not outline the responsibility for conducting internal control training. The policy does outline the procedures departments are to take regarding internal control and which party or parties bear responsibility for implementing controls.

Training is a component of the future model of the Finance Internal Control division, and will be at a more targeted, process-specific level. By having dedicated full-time staff, the team could monitor department performance, follow-up on policy implementation for areas they've reviewed already, and/or offer control-related training.

Recommendation: The Internal Control Division’s mission should include developing a training plan, including goals, objectives and curriculum.

Value Added: Risk Reduction

Finance Response: Agree. The Internal Control Division Strategic Operating Plan draft includes training and administration in the division’s service portfolio for COSO concepts in general, as well as policy, process and procedure specific roll-out and training for financial policies citywide.

5. Conduct an ERP System Post-Implementation Review



Per Grant Thornton report: The review would provide insight into system controls over segregation of duties and user access, whether the system is cost-beneficial, and meeting initial objectives/functional requirements. Based on this review, the City may use the information to prioritize resolution of system gaps, which would enhance the effectiveness and usefulness of the system. The City may also use the information to inform a decision whether to sunset Munis in the coming years and develop a transition plan, or to continue funding system updates and resolve contract issues with Tyler.

Action Taken: Though not a comprehensive post-implementation review, the RSM audit report on MUNIS ERP IT General Controls and Purchasing Workflow¹ (dated June 2019) found "moderate deficiencies" in the following areas: change management documentation, production changes review and approval, privileged-level access authorization, and delegation of duties (forwarding) within the purchasing workflow.

Auditors reviewed sufficient documentation to close the recommendations in the RSM report. The most recent Innovation & Technology Department (I&T) monthly report describes the early stages of an ERP system replacement project. The requirements for a potential new system were identified using system gaps, as recommended by Grant Thornton.

6. Perform an Enterprise Risk Management (ERM) Risk Assessment



Per Grant Thornton report: Formalize the comprehensive annual risk assessment process. Benefits include increasing awareness of fraud, waste, and abuse opportunities and the effectiveness of current control activities and process guidance. It would also ensure high-risk areas are adequately monitored and reviewed, not only by Internal Audit and an eventual Internal Control Program, but also by individual operational and internal service departments.

In January of 2016, the City’s Risk Management Division worked with the firm USI Insurance Services LLC (USI) to develop an Enterprise Risk Management (“ERM”) program. ERM is the process of identifying, prioritizing, and managing key risks. USI’s process consisted of six

¹ The scope of RSM’s audit follows: (1) MUNIS ERP System ITGC – logical security, security administration, operations and change management; (2) MUNIS Purchasing Workflow Diagnostic Review – accuracy and completeness of data, review and approval of expenditures prior to payment, segregation of duties.

steps from kick-off meetings and risk assessments to developing a single ERM governance structure.

Risk Management and USI completed steps 1-4; this process identified 160 individual risks across 10 departments. The Top 3 departments were: I&T (26), CMPD (23), and Aviation (20). The top risks categorized by type were “Human Capital” (28%) and “Safety” (18%). During FY 2022-2023 Internal Audit risk assessment meetings, departments noted that they participated in a risk assessment process but had not received any further direction, guidance, or instructions after completing the first steps in the program.

Recommendation: Risk Management should formalize an ERM framework and work with department representatives to identify and manage risks on a continual basis.

Value Added: Risk Reduction

Risk Management Response: Agree. The ERM framework and processes are created to provide an integrated strategic risk reduction process to organization wide risk. To address the ERM framework, Risk Management will move forward year one of a three-year project plan with the following components:

- a. Establish a “Tone at the Top” for ERM and integrated Safety.
- b. Review proposed framework and assessment and recommendation of ERM assessment completed in 2018 and update for current changes.
- c. Create an ERM Risk Mitigation Team.
- d. Propose and approve a City-wide Safety Policy in collaboration with the Finance Internal Control Division.
- e. Clarify what risks should be owned by city-wide safety and risk management.
- f. Begin to work with business units on deeper analysis of top risks and prepare recommendations for implementation.
- g. Begin to assess and develop mitigation tools.

7. Continue and Sophisticate the ERM Pilot



Per Grant Thornton report: An ERM framework has many benefits, including helping management identify new opportunities, identifying and managing entity-wide risks, increasing positive outcomes and advantage while reducing negative surprises, reducing performance variability, improving resource deployment, and enhancing enterprise resilience to change. This would assist in determining where to invest limited funds and ensure all management is on the same page on these decisions to advance the City.

The remaining/incomplete part of the City’s ERM process relates to USI’s steps 5-6: a deeper analysis of top risks and developing a single ERM governance structure. Additionally, ERM requires ongoing monitoring, including periodic risk assessments.

Recommendation: After formalizing an ERM framework, Risk Management should establish and communicate responsibilities for continuous monitoring and periodic risk assessments to ensure the framework continues to meet the City’s ERM objectives.

Value Added: Risk Reduction

Risk Management Response: Agree. After formalizing the ERM framework, Risk Management will determine the next steps required for continuous monitoring and periodic risk assessments.

8. Document IT System Controls in the System Security Document



Per Grant Thornton report: Document all IT system controls within a system security document, which should follow an internal control framework (such as COSO) and the ERM methodology. This documentation process would allow for a systems gap analysis to be conducted. It would also provide a consistent methodology for which IT system controls should be audited by the IT Internal Audit team. Controls should be thoroughly documented in the event of an internal control review, and to ensure that all system controls assess the confidentiality, integrity, and availability IT control assertions.

Auditors did not find evidence that this recommendation has been implemented or if it was properly communicated to the appropriate personnel. There is not a standard or framework followed that provides guidance on how system controls should be documented. However, auditors were able to confirm that some control documentation exists for specific applications. For example, the ERP Operations team was able to provide auditors with the Standard Operating Procedures (SOPs) related to Munis security. A comprehensive document describing all system controls does not exist.

Recommendation: The Finance Internal Control Division, in partnership with the I&T ERP Support Team, should establish internal control documentation standards for Finance managed systems (e.g. Munis, FMS, FICS, iNovah, and Concur) as well as integrated or non-integrated systems that complement the financial processes (e.g. OnBase).

Value Added: Risk Reduction

Finance Response: Agree. The Finance Internal Control Division will work with ERP Support to ensure that internal control objectives and technology functionality are addressed appropriately. During FY 2022, the Internal Control Division will include this recommendation as a project to be prioritized on the division workplan that is currently under development (see Item #3-Finance Response).

9. Determine Monitoring Activities



Per Grant Thornton report: Use process narratives (from control “deep dives”) to determine areas where monitoring control activities would be more beneficial than conducting annual or periodic control testing. The City should then work to increase the implementation of computer-aided monitoring techniques and the use of data analytics, such as the work that is already being done by Internal Audit and City Procurement to implement Tableau dashboards for p-card reviews. These techniques should be increased to encompass more types of transactions, such as contracts, invoices, and workflow changes. The responsibility for reviewing and performing the analytics should be taken on by Finance and the City’s operating departments, not just Internal Audit or the Internal Control Program, in order to monitor the accuracy of transactions and run reports on any deficient areas.

Departments have implemented various semi-automated monitoring controls. Notably I&T with Fleet/Fuelman usage and City-wide cellular devices and Procurement’s Contract Compliance report. While auditors have noted an increase in the use of dashboards and reports to monitor the accuracy of transactions, there was no documentation of the relationship of these reports to the overall system of controls.

To support the increase of computer-aided monitoring techniques, the City has created a datahub and put some (not all) MUNIS data in the data portal/Tableau dashboard. Additionally, data access is listed as a requirement for any new ERP system.

Recommendation: The Internal Control Division should document the relationship and responsibility for dashboards and continuous monitoring controls to the overall system of controls for specific processes.

Value Added: Compliance; Risk Reduction

Finance Response: Agree. The Finance Internal Control Division, in collaboration with policy/process owners from other Finance divisions, Finance leadership and city stakeholders, is responsible for establishing and documenting monitoring methods and metrics to support the integrity and function of the city’s financial internal control framework, as well as monitor compliance with policy and process in financial functions. This responsibility is included in the division’s Strategic Operating Plan draft. During FY 2022, the Internal Control Division will include this recommendation as a project to be prioritized on the division workplan that is currently under development (see Item #3- Finance Response).

Conclusion

Limited progress has been made to address Grant Thornton's most critical recommendations, which can significantly improve City-wide financial accounting internal controls.

Distribution of Report

This report is intended for the use of the City Manager's Office, City Council, and all City departments. Following issuance, audit reports are sent to City Council and subsequently posted to the [Internal Audit website](#).

Appendix

Grant Thornton's 2018 COSO Gap Analysis Recommended Actions	
Control Environment	<ul style="list-style-type: none"> • Identify and develop tone at the top • Implement Code of Conduct and annual required ethics training and incentivize staff to relentlessly integrate stewardship principles into their daily work routines • Design and conduct Internal Control Training for City of Charlotte employees and contractors to increase awareness and knowledge of the importance of adhering to set policies and procedures • Complete an organizational assessment to examine the City of Charlotte's organizational structure, roles and responsibilities of key stakeholders and departments, and organizational culture • Develop and further succession plans for key personnel and train back-ups as necessary
Risk Assessment	<ul style="list-style-type: none"> • Develop and design an integrated internal controls ERM framework, including an ERM risk assessment, to identify, document, mitigate, and monitor enterprise wide risks for continuous improvement • Ensure that the Internal Audit's annual audit plan and policy/procedure update timeline is properly aligned with resources and risk assessments
Control Activities	<ul style="list-style-type: none"> • Implement a risk-based Internal Control Program approach to integrate and coordinate internal controls across the organization and conduct deep-dives (TOD) into business processes • Document internal controls consistently within comprehensive cycle memos or narratives and CEM, including flowcharts documenting key controls • Develop comprehensive, consistent Standard Operating Procedures/job aids for all financial transactions completed across the City of Charlotte • Document IT system controls within a system security document • Conduct a post-implementation review of Munis to ensure system is operating effectively
Information & Communication	<ul style="list-style-type: none"> • Develop a schedule and consistent risk-based review process for updating city-wide policies and procedures on a continuous basis • Continuously update risk assessment and cycle memos, as well as policies and procedures, to ensure consistent and accurate information is communicated
Monitoring	<ul style="list-style-type: none"> • Conduct continuous or periodic control testing to ensure effectiveness of documented controls (as part of Internal Control Program) and remediate findings • Continue to develop computer-based analytic functions for monitoring/auditing financial transactions and control activities • Enhance and augment existing? Internal Audit IT division to increase oversight of the system