CITY OF SEAT PLEASANT, MARYLAND

INTERNAL AUDIT REPORT
OFFICE OF THE TREASURY

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Internal Auditor's Report

Mayor and City Council
The City of Seat Pleasant, Maryland

We have completed the audit of office of the Treasury of the City of Seat Pleasant. The purpose of the audit was to review its financial, operational, personnel and the accounting system up to the six months ended March 31, 2011.

We conducted the audit using due professional care, and planned and performed the audit to obtain reasonable assurance about whether the current practices of office of the treasury are consistent with best practices and are in compliance with applicable policies and procedures.

The audit identified a number of issues as well as areas for improvement. The issues are discussed in detail in subsequent sections of this report.

We extend our appreciation to the Mayor, Council, management and staff for their timely cooperation and assistance during the audit.

John C. Etoh, CPA, P.C.

John C. Etoh & CPA, P.C.

May 31, 2011

Executive Summary

Background:

The City was established in 1931 and is governed by an elected Mayor and elected City Council. The City provides the following services as authorized by its charter: public safety (police), highways and streets, sanitation, public improvements and general administrative services. The City is located within Prince George's County Maryland. Its major sources of revenue are real estate, income and usage taxes. As with other cities across the US the City of Seat Pleasant is experiencing the effects of the country's economic downturn. Chiefly led by the falling housing prices and the increase in home foreclosures the City has seen an erosion of real estate tax revenue.

The Office of the Treasurer is the financial arm of the City and is currently staffed with three employees, namely the Treasurer, an Accounting Manager and an Accounting Clerk. City revenue for the quarter ended December 31, 2010 was $2,558,031 and is $3,162,244 for the quarter ended March 31, 2011. This result indicates a 24% percent rise in revenue when the last two quarters are compared.

Audit Scope and Objectives:

The objective of this engagement is to evaluate the operations of the Office of Treasury to determine whether controls are in place to safeguard assets from waste, loss and abuse; and that said controls act as basis for the reliability of amounts reported in City's financial statements, including amounts that comprise the City's Financial Profile. Of particular interest are the City's accounting system, competence and adequacy of personnel assigned to accounting duties and processes flow. The work also will include an evaluation of the Office's monitoring system, the results of the inspections and the implementation of recommendations, if applicable. We are also required to analyze work flow in order to identify problems in control processes, and offer recommendations to expedite or improve controls. The audit will be

conducted in accordance with Government Auditing Standards issued by the Comptroller General of the United States ("The Yellow Book"). We used the risk based approach to judgmentally select completed financial transactions from throughout the six months ended March 31, 2011.

Summary of Audit findings:

City funds are invested in the manner prescribed by City's investment policy and are properly managed. Annual budgets are prepared and adopted as mandated by article VIII of the City. Written policies and procedures specific to accounting operations currently do not exist nor has the City approved or formally adopted what is currently available. Use of external auditors to perform annual internal control reviews as mandated by the City's policies and procedures has not been implemented. Responsibility for reviewing and approving employees' time records should rest with department supervisors and not the City Administrator. Purchasing policies and procedures are not always followed because what is currently available has not been formally adopted. Functions in the treasurer's office may be compromised because working space is small and the lack of Staff, consequently, City Treasurer is forced to perform the duties of the accounting Manager.

FINDINGS AND RECOMMENDATIONS

1. Lack of a comprehensive policies and procedures manual

Written policies and procedures specific to accounting operations currently do not exist. Audit procedures revealed that the Treasurer's office has proposed a draft containing purchasing, revenue collection and payroll procedures to the City Administrator since 2007. Once the comprehensive policies and procedures manual is completed, it should be forwarded to the Budget and Finance Committee of the City Council for review and approval, and then to the Council for a final approval and adoption. The draft is yet to be forwarded to the Budget and Finance Committee of the City Council for approval. Best practices require entities to develop and implement written policies and procedures manual as it is considered part of the entity's internal control. It also requires management to monitor, update and communicate these policies to employees regularly. The best form of communicating these procedures and updates is by including them as part of the City's website and reminding employees through emails to read the updates.

Several risks are associated with the lack of a comprehensive policies and procedures manual. For example, routine functions may have to be placed on hold in the absence of the employee who performs them. A well written procedures manual can act as a guide for other employees to perform these functions in the absence of the employee who regularly does them. The absence of a well written policies and procedures manual exposes city employees and departments to the risk of varying interpretations and inconsistent solution to problems that arise daily and inconsistent accounting treatment of transactions. To develop a culture of one voice,

one action for similar functions in various departments and ensure that similar transactions are given the same accounting treatment in the absence of the person who normally handles those transactions require the development and implementation of a comprehensive policies and procedures manual.

We recommend to the City to design, approve and implement a written policies and procedures manual to mitigate the risks described above. A good starting point would be the review, expansion and City wide adoption of the revenue, payroll and purchasing manual that is currently been used by the treasurer's office.

Management response: Management is in agreement with the recommendation and the City Administrator will implement the recommendation by August 1, 2011.

2. **Implement annual external review of City's internal controls of all the departments referenced in the City's annual budget**

This is the City's first external review of internal controls of the Treasury Department. City policies and procedures states "The City Administrator is responsible for establishing and maintaining an internal control structure designed to ensure that all assets of the entity are protected from loss, theft or misuse. Accordingly, the City Administrator shall establish a process for annual independent review by an external auditor to assure compliance with all policies and procedures".

The benefits of external annual review of all departments as required by the City's guidelines cannot be overstated. First, annual reviews may help the City to identify and analyze the risks relevant to achievement of its

objectives and forming the basis for determining how the risks should be managed. Secondly, because both employees and management are involved in these reviews the identification, capture and exchange of information in a form and time frame that enable people to carry out their responsibility become easier. Lastly, external review can be used as a monitoring device that assesses the quality of controls over time.

We understand that the City is conducting its first external review of controls, in the Treasurer's office, we do however, suggest that these reviews should not end with the Treasurer's office but rather should include all the departments referenced in the City's annual budget.

Management response: Management agrees with the recommendation and will implement the recommendation according to the following schedule:

a. Police Department	8/31/2011
b. Public Works	9/30/2011
c. City Clerk	10/31/2011
d. City Administration	11/30/2011
e. Mayor Office	12/31/2011
f. City Council	01/31/2012
g. Economic Development	02/28/2012
h. Code Enforcement	08/31/2011
i. Nuisance Abatement	08/31/2011

3. **City Administrator should not sign or approve time records**

Of the three time sheets reviewed two were not signed by both the supervisors and the employees and one request for leave was not signed to indicate whether the leave was properly approved or declined. The departments need

to designate someone within the department to review employee time sheets for accuracy and ensure that all time sheets are signed by the employees and approved by their supervisors. This appear to be a very high error rate given the number of samples examined and indicates that time records are not being monitored within the various departments. There is currently a policy, which requires employees to sign and forward their time sheets to their immediate Supervisor for approval. The immediate Supervisors are better informed about the work performed by subordinates and can easily identify falsifications and other inherent errors. Sending time records to the City administrator or others who do not have thorough knowledge of the employee and their work, nor time is inconsistent with best practices.

As we noted before a written and comprehensive manual helps to ensure that policies and procedures are adhered to. And, in the absence of monitoring mechanisms the City is exposed to potential fraud, abuse and waste. This finding is also consistent with our remark that City should perform annual internal reviews to ensure that control activities are being performed.

We recommend that employee immediate Supervisors sign time sheets to indicate approval and concurrence with the information therein before they are forwarded to Treasury for processing even though the City manual charges this responsibility to the City Administrator. We also recommend that the policy requiring employee signature and supervisor approval on time sheets be implemented immediately.

Management response: Management agrees with Auditor's finding and the City Administrator will implement Auditor's recommendations by 8/1/2011.

4. **Policies and procedures for purchasing are not always followed**

Of the fourteen purchase order files reviewed we found that one order was not properly authorized and in ten others there were no indication that expenditures were approved by the City Administrator. While the error rate is not high, it is however necessary to follow the current policy, which mandates that expenditures should be authorized and pre approved based on budgeted authority before purchases can be made.

Good controls when adopted and implemented helps the entity to detect and prevent errors and abuse as work is being done. When controls are not properly designed or monitored errors may go undetected and consequently expose the city to risks of fraud and abuse.

We recommend that all purchases should be approved by the City Administrator before goods are acquired or payments made.

Management response: Management agrees with the findings and City Administrator will implement Auditor's recommendations by 12/31/2011.

5. **Accounting Manager position should be clearly defined**

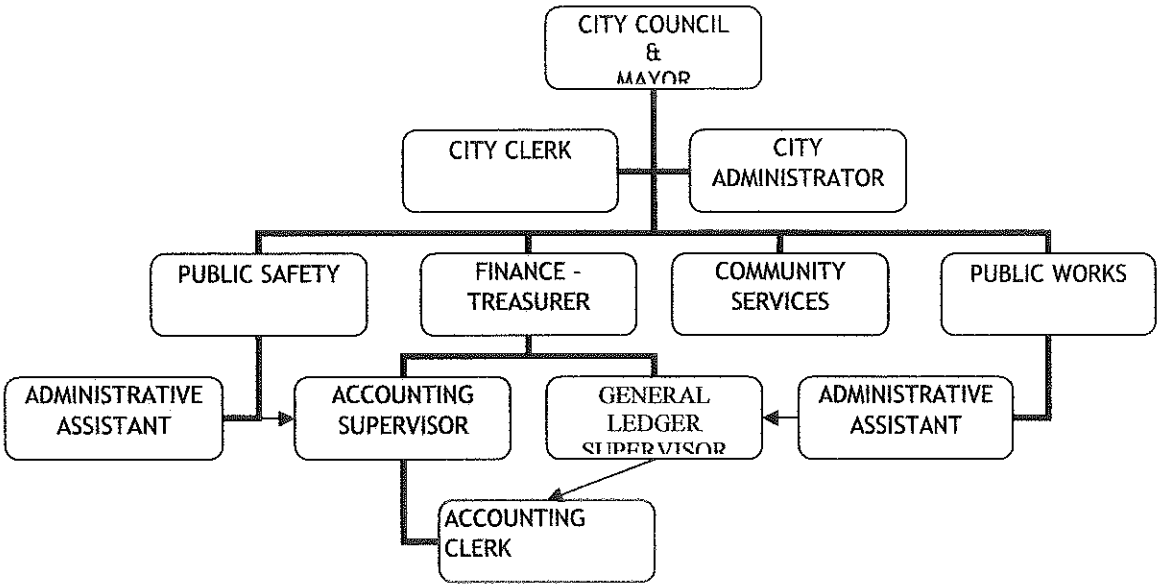
Based on inquiries and observations made during our audit it appeared that roles in the treasurer's office are not clearly defined and that proper segregation of duties may be compromised because of the small working space and inadequate staffing. Currently it appears that the accounting manager performs the work of an accounting clerk and that most of the lifting in the department is being done by the Treasurer. Treasurer is then overburdened with routine activities that should be performed by the accounting manager.

Given the information received from the accounting manager it appears that inconsistencies exist between her description of the position and what the position ought to be.

If the positions are clearly defined and the skill-sets necessary to effectively perform the duties are identified and engaged, then the Treasurer will be freed to focus on the areas that are most beneficial to the City. For example, update and expansion of a comprehensive operating manual requires the treasurer level of skill set. It will also allow the treasurer to monitor financial operations throughout the City. Based on our audit, the lack of monitoring appears to be pervasive throughout the City.

Based on our audit we believe that the City will benefit by re-organizing the Treasurer's Office. First, the City should or hire a consultant to perform an evaluation of the positions immediately, identify skill-sets needed and update current employees' skills. Secondly, the City should consider hiring a general ledger supervisor and changing the accounting manager position to an accounting supervisor. Treasurer can provide the overall monitoring needed in this department. Meanwhile we believe that the updated organization chart below optimizes City functions.

PROPOSED ORGANIZATION CHART



Management Response: Management agrees with the findings and in concert with a consulting firm the City Treasurer will implement the recommendation by 8/31/2011.

6. Annual inventory of City's assets are not being conducted

Audit procedures performed on fixed assets revealed that the City have not conducted annual inventory of assets. Inventory of assets would help the City identify obsolete items, assets to be disposed of, plan for replenishments and provide the impetus for the reliability of the amounts stated in financial statements.

City is exposed to the risk of theft, waste and abuse when inventory count is not performed. More importantly, the City runs the risk of being unprepared in

emergencies if the equipment that they would rely on to manage the risk cannot perform, is inadequate and/or is obsolete when needed.

To mitigate these risks we recommend that the City perform an inventory count in the interim and henceforth that the City makes inventory count an annual event.

Management response: City administrator agrees with Auditor's finding and would in concert with a consulting firm conduct an interim inventory count and would do so annually after the initial inventory.