

**Performance Audit 18-03:
Control Environment**

November 2018

City Auditor

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OFFICE OF INTERNAL AUDIT

Stan Sewell, City Auditor

November 29, 2018

To: Mayor Andy Berke
City Council Members

Subject: Control Environment (Audit Report #18-03)

Dear Mayor Berke and City Council Members:

The attached report contains the results of our audit of the City's control environment. Our audit ascertained the City's Internal Control Manual addresses all five of the specific principles related to the control environment. However, we found areas for improvement related to internal control, ethics, policies, procedures and performance evaluations. As a result, we recommended specific opportunities to enhance the control environment.

We thank the city council, administration, staff and audit committee for their cooperation and assistance during this audit.

Sincerely,

Stan Sewell, CPA, CGFM, CFE
City Auditor

Attachment

cc: Audit Committee Members
Jim Arnette, Tennessee Local Government Audit
Stacy Richardson, Chief of Staff
Maura Sullivan, Chief Operating Officer
Daisy Madison, Chief Financial Officer
Beverly Moultrie, Director of Human Resources

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AUDIT PURPOSE

This audit was conducted in accordance with the Office of Internal Audit's 2018 Audit Agenda. The objective of this audit was to determine if the City of Chattanooga has an adequate control environment for the foundation of an effective internal control system.

BACKGROUND

The City of Chattanooga operates under a home rule charter which defines its governmental structure and powers. Home rule means the City may adopt and change its charter by local referendum. The Mayor has all executive and administrative authority, while the City Council has all legislative authority. The Council is composed of nine members, with members elected from each of the nine districts within the geographic boundaries of the City.



Internal controls, including integrity and ethical values, are an integral part of the City's process to achieve desired objectives and outcomes related to safer streets, smarter students and stronger families, a growing economy, stronger neighborhoods, and high performing government. Internal Control is simply what the City does to see that the things the City wants to happen will happen, and the things the City doesn't want to happen will not happen.

To further understand internal control, it includes policies that establish what should and should not be done, and procedures that are in place to implement the policies. Furthermore, it is important to note internal control is effected by people. It's not merely policy manuals and forms, but actions by people at every level of the City's organization.



City Council and the Administration have complementary roles to play in regard to internal control. The Administration is primarily responsible for designing, implementing, operating and following a comprehensive framework of internal control. On the other hand, City Council, as part of its oversight duty, is ultimately responsible for making sure the Administration does so.

To put it into perspective, internal control comes with a price tag. It is illogical to allow the cost of internal control to exceed the resulting benefits. Therefore, the goal of internal control is to provide reasonable assurance rather than absolute assurance. This is because internal control involves human beings who are prone to errors of judgment, mistakes and moral lapses. Additionally, unexpected events sometimes prevent achievement of objectives and desired outcomes.

To strengthen internal control, the City has developed an Internal Control Manual¹ required by Tennessee Code Annotated, Section 9-18-102(a). The manual is based on the five components of internal control included in the Tennessee Comptroller's Internal Control and

¹ City of Chattanooga, *Internal Control Manual*, Department of Finance & Administration, June 30, 2016.

Compliance Manual² and the U.S. Government Accountability Office's (GAO) Green Book³.

The City's manual includes the five components of internal control: Control Environment; Risk Assessment; Control Activities; Information and Communication; and Monitoring. The five components were originally included in the model developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). This internal control framework is generally recognized as the standard against which organizations measure their effectiveness of internal control.



The COSO Cube

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This audit focuses on the Control Environment component which is the foundation of an effective system of internal control. It includes the attitude and actions of the City Council and the Administration regarding the importance of control within the City. The control environment provides the discipline and structure for the achievement of objectives and desired outcomes of the City. Simply put, “The control environment sets the tone of an organization, influencing the control consciousness of its people.”⁴

Finally, an ineffective control environment could result in front-page news stories which no city wants to be a part. An example of a city that had a poor control environment was Dixon, Illinois, where the City Comptroller stole \$30 million over six years because of weak internal control. Other non-government examples of a poor control environment, include Enron, WorldCom and Equifax who made news headlines due to a lack of effective internal control.

² State of Tennessee, Tennessee Comptroller of the Treasury – *Internal Control and Compliance Manual for Governmental Entities and Other Audited Entities in Tennessee*, Internal Control Framework, December 2015.

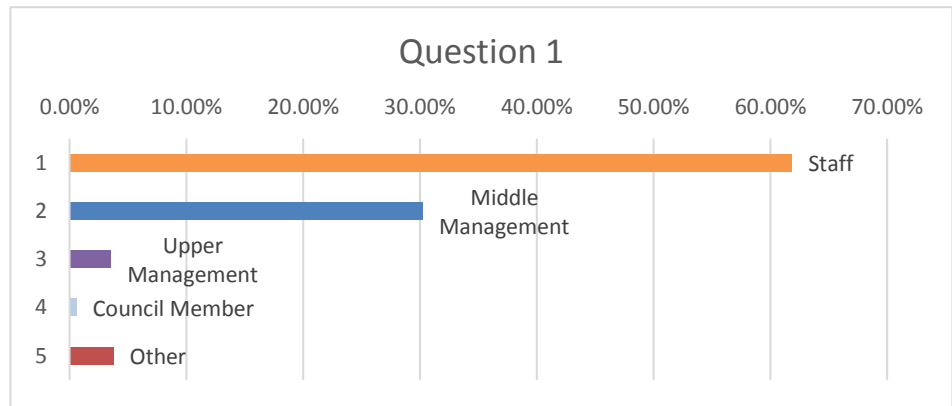
³ Comptroller General of the United States, United States Government Accountability Office, *Standards for Internal Control in the Federal Government*, September 2014.

⁴ The Institute of Internal Auditors, IPPF – Practice Guide, *Auditing the Control Environment*, April 2011, page 2.

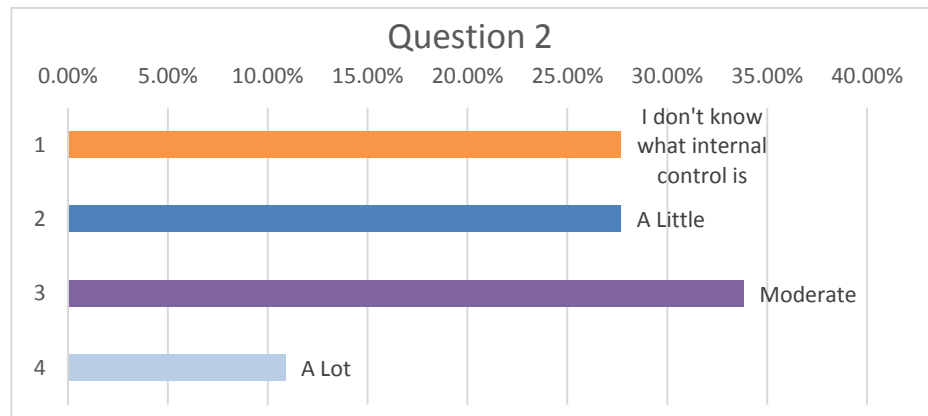
Control Environment Survey

To evaluate the effectiveness of the control environment, an anonymous survey was conducted to determine the council’s, management and staff’s understanding and opinion of the City’s control environment. A summary⁵ of the results are as follows:

Q1 Which role best describes your position within the City of Chattanooga?

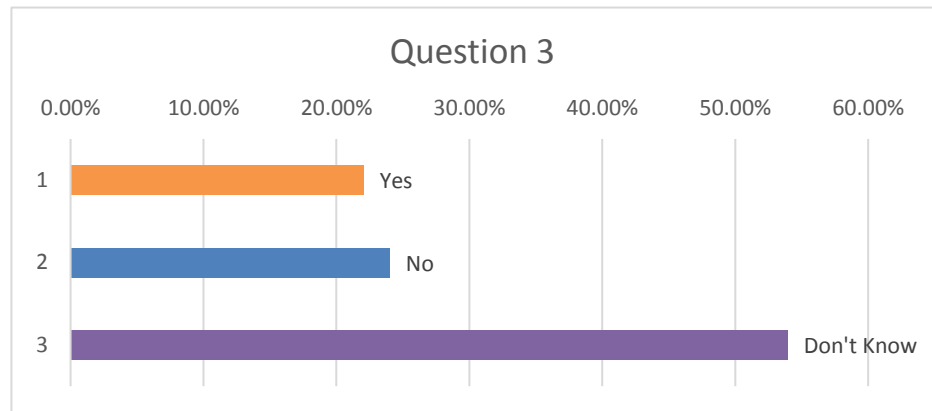


Q2 What is your level of understanding of internal control?

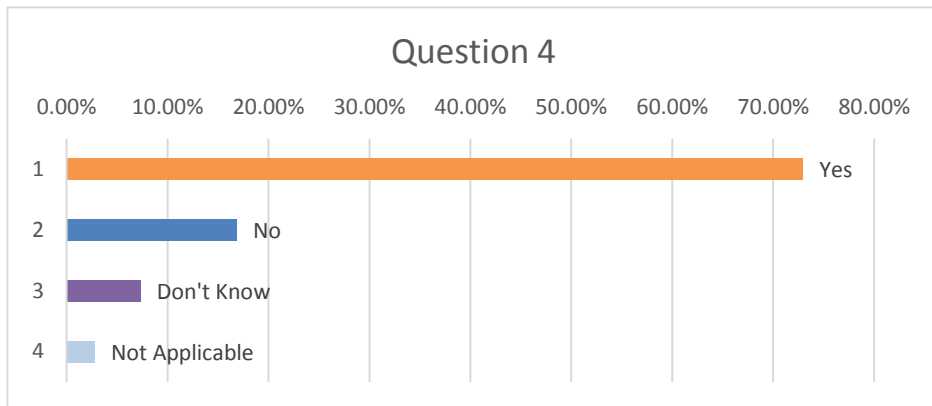


⁵ Appendix B includes overall survey results and a breakdown of the survey results by position.

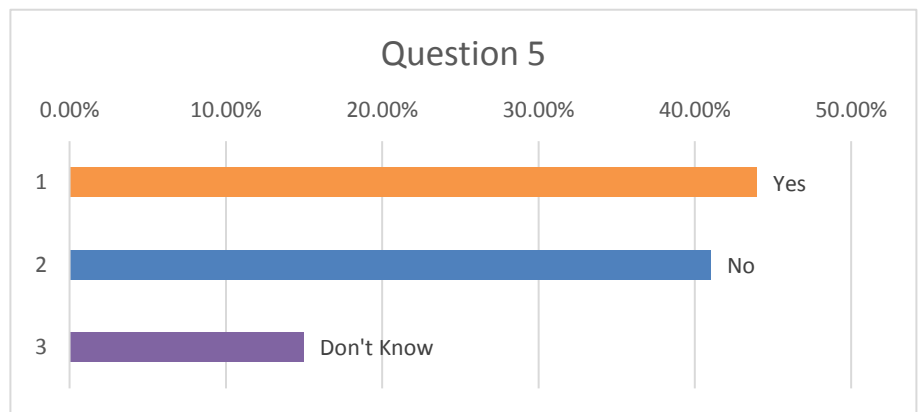
Q3 Do you know if the City of Chattanooga has an internal control manual?



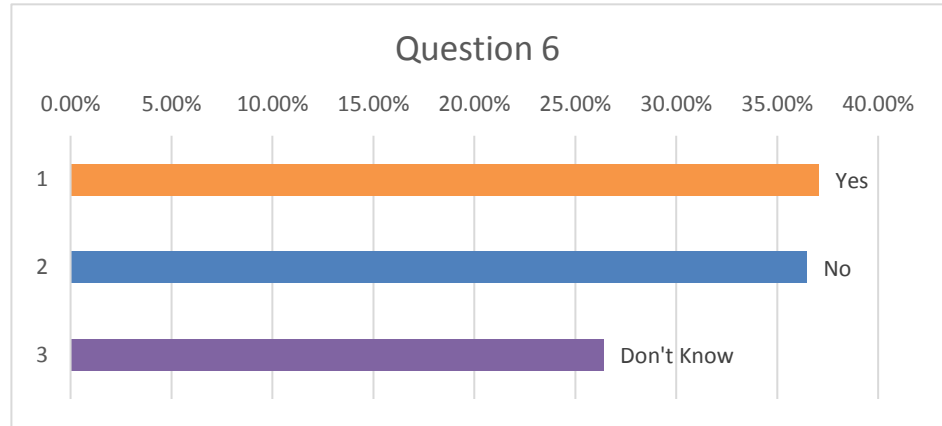
Q4 Does your supervisor demonstrate high ethical standards?



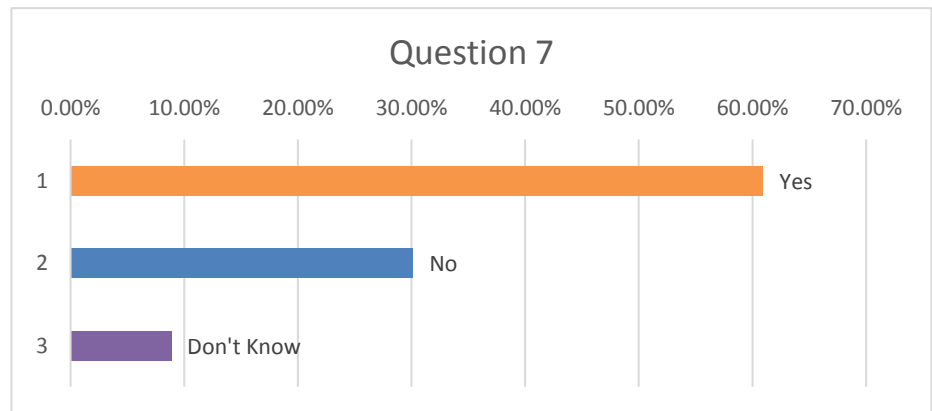
Q5 If you report wrongdoing, are you confident the wrongdoing will stop?



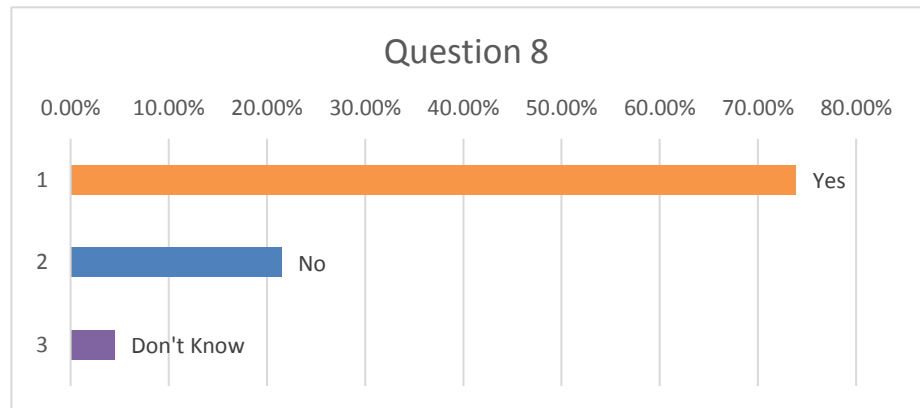
Q6 If you report wrongdoing, do you believe you would experience retaliation?



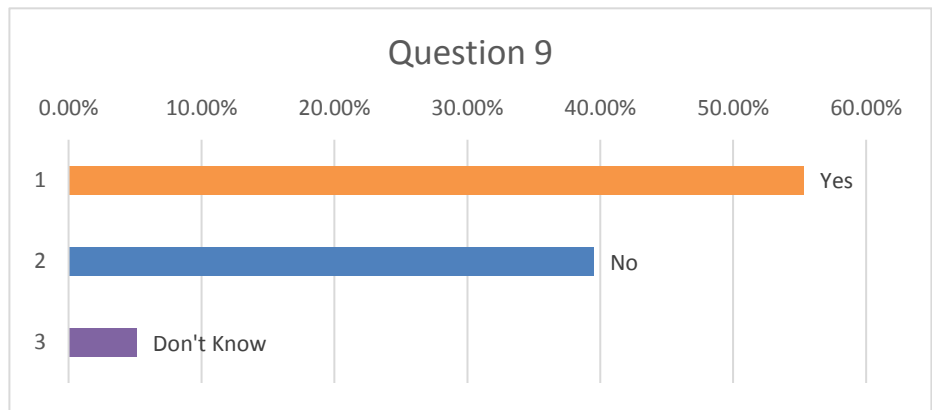
Q7 Do your department's policies and procedures help you do your job effectively?



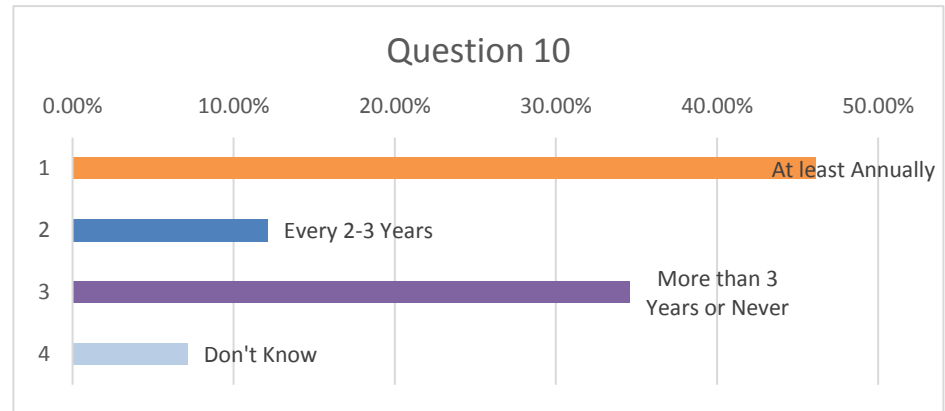
Q8 Have your job responsibilities and reporting relationships been clearly established and communicated to you?



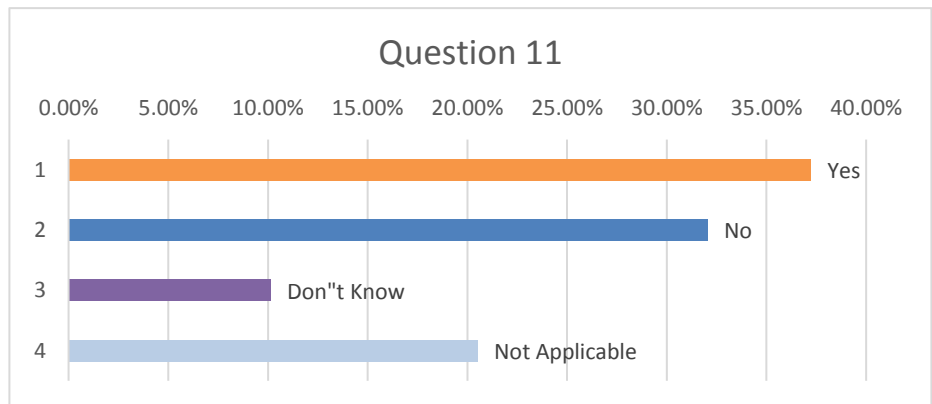
Q9 Are you satisfied with the training opportunities made available to you?



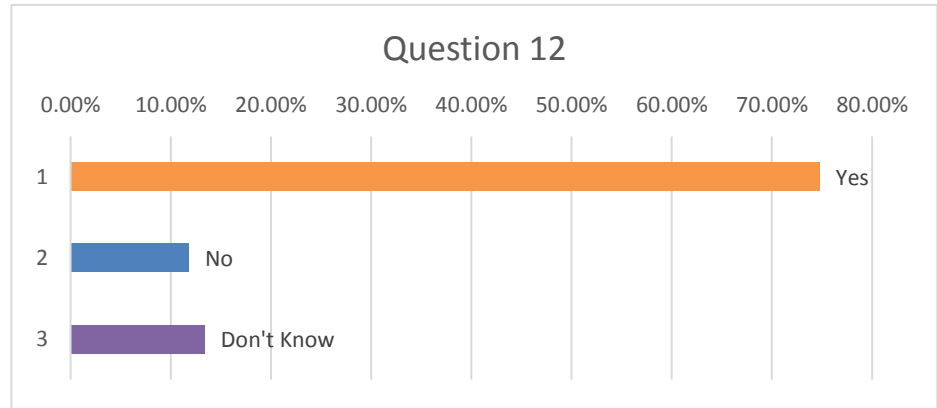
Q10 Do you receive a periodic job evaluation or performance appraisal?



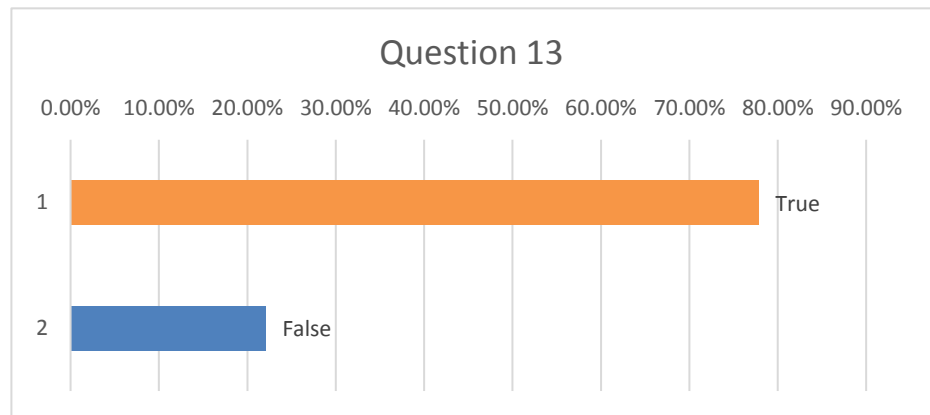
Q11 If you receive a periodic job evaluation or performance appraisal, do you feel it is beneficial?



Q12 Do you have a way to report fraud, waste or abuse?



Q13 I feel having a well-run City is a top priority for the City's leadership.



FINDINGS AND RECOMMENDATIONS

Promote Awareness of Internal Control

Internal controls are part of the City's daily operations. Effective internal control systems are comprehensive and involve all employees throughout the City. It is simply what the City does to see the things they want to happen will happen, and conversely the things they don't want to happen will not happen.

Twenty-eight percent of the control environment survey respondents didn't know what internal control is and 78% of respondents didn't know the City of Chattanooga has an internal control manual.⁶ Without a sufficient understanding of internal controls, it is difficult for employees to comprehend all employees of the City are responsible for compliance. Employees should be well acquainted with internal controls related to their job responsibilities.

Recommendation 1:

We recommend city administration collaborate to develop employee training on internal control, as well as provide access to the manual. The training should include the annual updates made to the internal control manual.

Auditee Response: We concur with the audit finding and recommendation.

Enhance the City's Ethics Program

An ethics program provides employees with a clear understanding of what's acceptable and ethical behavior. For example, the program guidelines should explain the standards related to a conflict of interest. In this case, employees can refer to the program guidelines to find out what constitutes a conflict of interest and that it is their responsibility to report information about unethical conduct.

A majority of survey respondents are not confident wrongdoing will stop if it is reported and only 36% of survey respondents were confident they would not experience retaliation if they reported wrongdoing.⁷ For an ethics program to be effective, employees must be confident their concerns will be taken seriously and they will not suffer personal reprisals.

⁶ Control Environment Survey questions 2 and 3.

⁷ Control Environment Survey questions 5 and 6.

Recommendation 2:

We recommend city administration provide annual ethics training for all employees, including ethical decision-making with scenarios that employees might encounter in their jobs. All levels of management must ensure employee concerns are welcomed and properly addressed. When improper activity is identified, management must set an example by demonstrating commitment to high ethical standards. Actions should be clear and sufficient to demonstrate inappropriate activity will not be tolerated. The annual training requirement should be included in the next revision of the Employee Information Guide (EIG).

***Auditee Response:** We concur with the audit finding and recommendation.*

Improve Employee Understanding of Policies & Procedures through Effective Communication

Policies and procedures are an important component of internal control for all organizations. Moreover, they are a clear communication to employees as to what is acceptable and how they are expected to perform the responsibilities of their job. In addition, well-developed policies and procedures show an organization is being managed effectively and ensures consistency in operating procedures.

Only 61% of survey respondents believe their department's policies and procedures help them do their jobs effectively.⁸ When they are perceived as ineffective, the policies and procedures may not be well written, may not be comprehensive, may not have been adequately explained or consistently applied.

Recommendation 3:

We recommend city administration coordinate regular departmental training on relevant policies and procedures. Also, there should be an annual review of policies and procedures at all management levels within each department.

***Auditee Response:** We concur with the audit finding and recommendation.*

⁸ Control Environment Survey question 7.

Reinvent the Employee Performance Review Program

Performance reviews are an important line of communication between management and employees. Furthermore, it's an opportunity for management to provide employee feedback, identify poor or exceptional performance and set expectations of performance. It's also an opportunity for employees to provide feedback or ask questions about their job or future opportunities.

Only 58% of survey respondents indicated they receive a job evaluation at least annually or every 2-3 years.⁹ The City's Employee Information Guide states, "Once the probationary period has ended, supervisors shall evaluate their employees on an annual basis."

Also, 53% of survey respondents, who received an evaluation, do not feel or do not know if their performance appraisal is beneficial.¹⁰ When used properly, reviews should update an employee on their performance, provide an opportunity to express appreciation for a job well done, address performance issues and improve morale.

Recommendation 4:

We recommend city administration redesign the City's Employee Performance Review Program to provide evaluations on an annual basis. The administration should hold managers and supervisors accountable when they fail to conduct annual evaluations of their direct reports. Also, the administration should ensure individuals placed in supervisory positions possess the competency to be managers. Sufficient training should be required for managers to ensure they are knowledgeable of the areas they supervise and have appropriate leadership skills. The next revision of the EIG should include a provision requiring the Human Resources Department ensure an annual evaluation is performed for all employees.

***Auditee Response:** We concur with the audit finding and recommendation.*

Additional Control Environment Attributes

As previously discussed in the background section of this report, the City's Internal Control Manual is based on the five components of internal control included in the Tennessee Comptroller's Internal Control and Compliance Manual and the U.S. Government Accountability Office's (GAO) Green Book. The comptroller's manual and green book set forth some control environment attributes that are not included in the city's manual, as follows:

⁹ Control Environment Survey question 10.

¹⁰ Control Environment Survey question 11.

Establish Systematic Succession Planning

Succession planning is important to the continuing operations of the city upon turnover of employees. Importantly, it recognizes the fact that employees will not be with the city forever and plans for their replacement upon departure. For example, an aging workforce, commonly known as the “Silver Tsunami”, is now exiting the workforce, creating a drain on leaders and knowledge.

Succession planning is challenging, complicated and sometimes not a high priority in the public sector. The lack of succession planning increases the risk related to the lack of required skill sets, as well as the loss of institutional knowledge.

Recommendation 5:

We recommend city administration develop a workforce succession plan.

Auditee Response: We concur with the audit finding and recommendation.

Consider Excessive Pressure and Workplace Stress

Excessive pressure in the workplace negatively effects many adults in the workplace. Job stress is associated with increased rates of heart attacks, hypertension and other disorders.¹¹ Also, excessive pressure and stress can contribute to lower engagement, less productivity and higher absenteeism levels.¹²

The City has an Employee Assistance Program (EAP) to help employees cope with problems before they become unmanageable. However, there is not a developed set of formal policies and procedures to fully and comprehensively address excessive job pressures and workplace stress. For example, pressure and stress can result from excessive overtime or unrealistic expectations.

Recommendation 6:

We recommend city administration develop a program, policies and procedures to monitor and manage excessive job pressure and workplace stress. Additionally, as part of the formal performance

¹¹ *Workplace Stress*, The American Institute of Stress, www.stress.org/workplace-stress/.

¹² *Workplace Stress Leads To Less Productive Employees*, Karen Higginbottom, www.forbes.com/sites/karenhigginbottom/2014/09/11/workplace-stress-leads-to-less-productive-employees/#758cecf031d1 .

review program, excessive job pressure and workplace stress should be discussed with each employee.

***Auditee Response:** We concur with the audit finding and recommendation.*

Update the City's Internal Control Manual

When reviewing the City's Internal Control Manual¹³, we noted the relationship of the City Council, Audit Committee and the Office of Internal Audit was not described accurately. We also noted the organizational chart in Section 3.1.3 is not up to date and the manual has not been updated since its effective date of June 30, 2016. The manual on page 3 states the internal control system must be reviewed and updated at least annually.

As previously discussed, the city council and management have complementary roles to play in regard to internal control. Management is "primarily responsible" for designing, implementing, operating, and maintaining a comprehensive framework of internal control. Whereas, city council, as part of its oversight duty, is "ultimately responsible" for making sure that management does so.

Recommendation 7:

We recommend finance and administration review and update the Internal Control Manual.

***Auditee Response:** We concur with the audit finding and recommendation.*

¹³ City of Chattanooga, *Internal Control Manual*, Department of Finance & Administration, June 30, 2016, page 4, Section 3.1.2 Oversight of the internal control system.

APPENDIX A: SCOPE, METHODOLOGY AND STANDARDS

Based on the work performed during the preliminary survey and the risk assessment, the audit covers the control environment for the 2018 fiscal year. When appropriate, the scope was expanded to meet the audit objectives. Documentation was obtained from the City of Chattanooga Employee Portal/Employee Resources, staff and authoritative external sources. Copies were used as evidence and verified through physical examination.

To evaluate the adequacy of the control environment, we examined the documentation and processes relative to the control environment. We interviewed selected employees, council and audit committee members to determine their perception of the control environment. We conducted a control environment survey to determine the perception of the control environment of employees, city council and the audit committee. A total of 506 individuals, including full-time and part-time employees, responded to the control environment survey, resulting in a response rate of approximately 17%.

To develop our recommendations, we tabulated the results of the control environment survey, reviewed the Tennessee Comptroller's Internal Control and Compliance Manual and the U.S. Government Accountability Office's (GAO) Green Book, along with best practice alternatives. We also discussed ideas to strengthen the control environment with administrative and management employees.

We conducted this performance audit from June 2018 to October 31, 2018 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.

APPENDIX B: OVERALL SURVEY RESPONSES AND BY POSITION

Control Environment Survey						
Responses by Position						
	Overall	Staff	Middle Mgmt	Upper Mgmt	Council	Other
Q1 Which role best describes your position within the City of Chattanooga?						
Number of Responses	506	313	153	18	3	19
Percentage of Responses	100%	62%	30%	4%	1%	4%
Q2 What is your level of understanding of internal control?						
I don't know what internal control is	28%	32%	22%	6%	0%	32%
A Little	28%	26%	34%	11%	0%	32%
Moderate	34%	33%	33%	50%	100%	26%
A Lot	11%	9%	12%	33%	0%	11%
Q3 Do you know if the City of Chattanooga has an internal control manual?						
Yes	22%	18%	28%	39%	0%	21%
No	24%	23%	29%	17%	0%	16%
Don't Know	54%	59%	43%	44%	100%	63%
Q4 Does your supervisor demonstrate high ethical standards?						
Yes	73%	72%	74%	94%	33%	78%
No	17%	18%	16%	6%	0%	22%
Don't Know	7%	7%	9%	0%	33%	0%
Not Applicable	3%	3%	2%	0%	33%	0%
Q5 If you report wrongdoing, are you confident the wrongdoing will stop?						
Yes	44%	39%	55%	61%	33%	37%
No	41%	46%	34%	22%	33%	37%
Don't Know	15%	16%	11%	17%	33%	26%
Q6 If you report wrongdoing, do you believe you would experience retaliation?						
Yes	37%	39%	36%	17%	33%	32%
No	36%	33%	39%	56%	33%	47%
Don't Know	26%	28%	24%	28%	33%	21%

Control Environment Survey						
Responses by Position (Continued)						
	Overall	Staff	Middle Mgmt	Upper Mgmt	Council	Other
Q7 Do your department's policies and procedures help you do your job effectively?						
Yes	61%	55%	68%	89%	100%	63%
No	30%	33%	28%	11%	0%	26%
Don't Know	9%	12%	4%	0%	0%	11%
Q8 Have your job responsibilities and reporting relationships been clearly established and communicated to you?						
Yes	74%	71%	78%	83%	33%	84%
No	22%	23%	19%	17%	67%	11%
Don't Know	5%	6%	3%	0%	0%	5%
Q9 Are you satisfied with the training opportunities made available to you?						
Yes	55%	51%	63%	44%	100%	63%
No	40%	43%	34%	44%	0%	32%
Don't Know	5%	6%	3%	11%	0%	5%
Q10 Do you receive a periodic job evaluation or performance appraisal?						
At least Annually	46%	47%	41%	33%	50%	74%
Every 2-3 Years	12%	12%	15%	0%	50%	11%
More than 3 Years or Never	35%	34%	38%	44%	0%	16%
Don't Know (I have been employed less than 1 year)	7%	7%	6%	22%	0%	0%
Q11 If you receive a periodic job evaluation or performance appraisal, do you feel it is beneficial?						
Yes	37%	38%	38%	22%	0%	37%
No	32%	31%	32%	28%	100%	47%
Don't Know	10%	11%	9%	0%	0%	16%
Not Applicable	21%	20%	21%	50%	0%	0%
Q12 Do you have a way to report fraud, waste or abuse?						
Yes	75%	70%	82%	94%	67%	74%
No	12%	13%	9%	6%	33%	11%
Don't Know	13%	16%	9%	0%	0%	16%
Q13 I feel having a well-run City is a top Priority for the City's leadership.						
TRUE	78%	77%	78%	94%	33%	89%
FALSE	22%	23%	22%	6%	67%	11%

City of Chattanooga Fraud, Waste, and Abuse Hotline

Internal Audit's Fraud, Waste, and Abuse Hotline gives employees and citizens an avenue to report misconduct, waste or misuse of resources in any City facility or department.

Internal Audit contracts with a hotline vendor, The Network, to provide and maintain the reporting system. The third party system allows for anonymous reports. All reports are taken seriously and responded to in a timely manner. Reports to the hotline serve the public interest and assist the Office of Internal Audit in meeting high standards of public accountability.

To make a report, call 1-877-338-4452 or visit our website:

www.chattanooga.gov/internal-audit