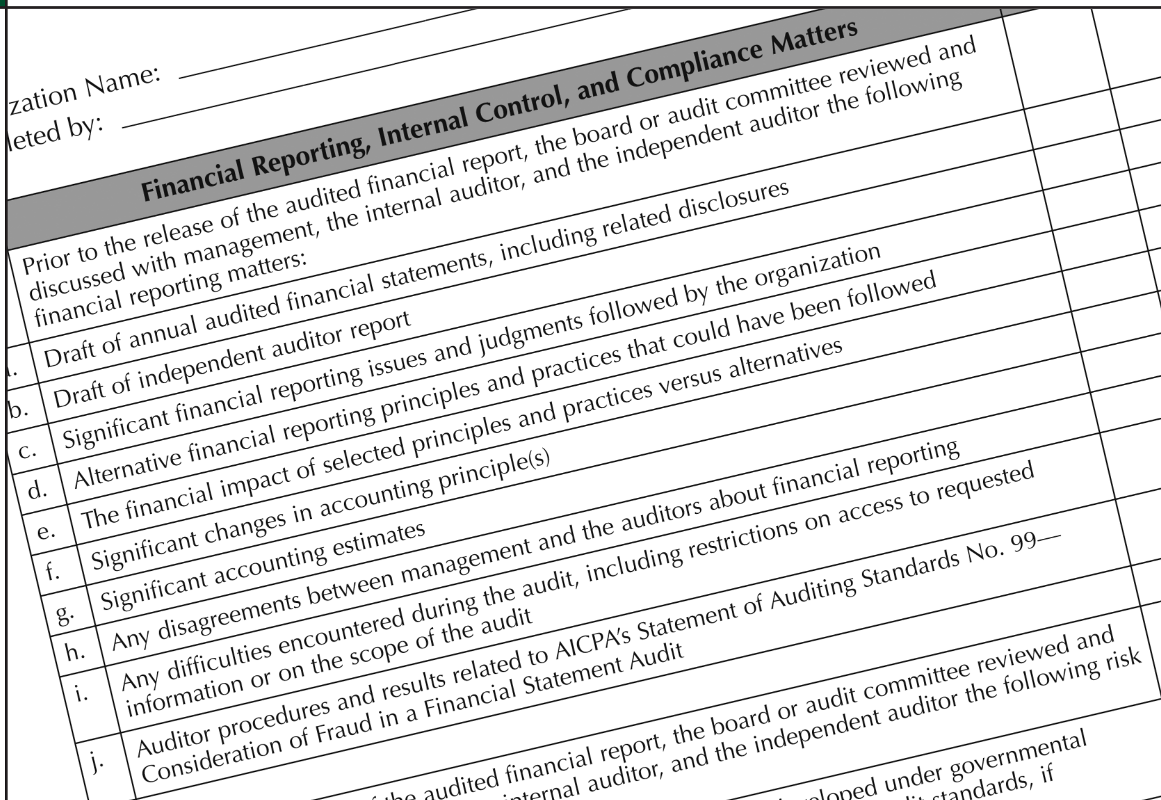
Strengthening Control and Integrity: A Checklist for Government Managers


zation Name:
leted by:

	Financial Reporting, Internal Control, and Compliance Matters
	Prior to the release of the audited financial report, the board or audit committee reviewed and discussed with management, the internal auditor, and the independent auditor the following financial reporting matters:
a.	Draft of annual audited financial statements, including related disclosures
b.	Draft of independent auditor report
c.	Significant financial reporting issues and judgments followed by the organization
d.	Alternative financial reporting principles and practices that could have been followed
e.	The financial impact of selected principles and practices versus alternatives
f.	Significant changes in accounting principle(s)
g.	Significant accounting estimates
h.	Any disagreements between management and the auditors about financial reporting
i.	Any difficulties encountered during the audit, including restrictions on access to requested information or on the scope of the audit
j.	Auditor procedures and results related to AICPA's Statement of Auditing Standards No. 99—Consideration of Fraud in a Financial Statement Audit

James A. Bailey
Professor of Accounting
Utah Valley University

Financial Management Series

IBM Center for
The Business of Government

2010

FINANCIAL MANAGEMENT SERIES

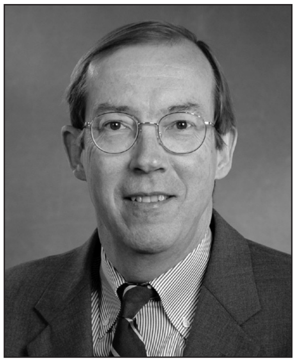
Strengthening Control and Integrity: A Checklist for Government Managers

James A. Bailey
Professor of Accounting
Utah Valley University

IBM Center for
The Business of Government

TABLE OF CONTENTS

FOREWORD



Jonathan D. Breul

Denise Rabun

On behalf of the IBM Center for The Business of Government, we are pleased to present this report, “Strengthening Control and Integrity: A Checklist for Government Managers,” by Professor James A. Bailey.

With the enactment of the American Recovery and Reinvestment Act (ARRA) of 2009 and the extensive reporting requirements stemming from this new legislation, government managers are faced with even greater demands for fiscal accountability and transparency. Maintaining financial integrity over agency data is especially important given the amount of information the public can now access through websites such as Recovery.gov and USASpending.gov. Because of such public scrutiny, government managers must be even more vigilant in ensuring the soundness and quality of their data.

As an introduction of control and integrity processes and tools, Professor Bailey has developed this report as a guide to be used by government managers in managing risks to strengthen their financial control and integrity processes.

This is the second recent IBM Center report focused on the challenge of effective controls and managing risk. Earlier this year, the IBM Center published the second edition of “Managing Risk in Government: An Introduction to Enterprise Risk Management” by Karen Hardy. In that report, Dr. Hardy describes how Enterprise Risk Management systems can help reduce the total cost of compliance while helping agencies achieve greater value from their risk management activities. Together, that report and Professor Bailey’s report provide state-of-the art overviews on how governments at all levels can improve their control and risk management activities.

The report by Professor Bailey provides valuable information to public officials across the nation, from senior management to staff responsible for overseeing day-to-day operations, in managing financial and ethical risks inherent in most governmental activities. The best practices examples from local governments and financial oversight and integrity checklists contained in the report provide sound guidance to facilitate the strengthening of financial controls and integrity across government. We trust you will find this report informative and helpful.

Jonathan D. Breul
Executive Director
IBM Center for The Business of Government
jonathan.d.breul@us.ibm.com

Denise Rabun
Public Sector Financial Management
Partner, IBM Global Business Services
denise.rabun@us.ibm.com

Introduction

The Challenge of Risk Management

Governmental organizations manage risk on a daily basis. Unfortunately, many governmental organizations manage risk in a haphazard, unsystematic way. While organizations may address a few risks, they do not systematically manage other important threats and opportunities. This unsystematic approach limits the ability of organizations to achieve important outcomes.

In many organizations, government management does not avail itself of the benefits of a systematic approach to managing risks. Some managers may not understand how to implement risk management activities. Others may not believe that risk management activities can benefit their organization. Still others delay implementing such activities.

This report is aimed at government managers as they address the problems most governmental organizations face. The report presents an overall framework for managing risks; specifically, financial controls and integrity. It describes the benefits of implementing such a framework. It shows how to systematically implement financial control and integrity activities. These management processes benefit governmental organizations by helping them identify, prioritize, and focus their resources to produce high-impact opportunities and reduce high-impact threats.

Enterprise Risk Management Frameworks

Several risk management frameworks exist. The most well known is the Committee of Sponsoring Organizations of the Treadway Commission's (COSO) Enterprise Risk Management—Integrated Framework, which identifies eight components of a risk management process. These interrelated components include the internal environment, objective setting, event identification, risk assessment and response, control activities, communication, and monitoring.

The U.S. Government Accountability Office (GAO) Risk Management Framework follows a pattern similar to that of the COSO Enterprise Risk Management—Integrated Framework. The GAO Risk Management Framework phases include strategic goals, objectives, and constraints; risk assessment; alternative evaluation; management selection; and implementation and monitoring. Information and communication is at the center of these activities.

The IBM Center for The Business of Government published Karen Hardy's *Managing Risk in Government: An Introduction to Enterprise Risk Management* in 2010 (2nd ed.) That report provides an excellent overview of the risk management literature and terminology. This report shows government managers detailed guidance on how to implement practical applications of these risk management components in their organizations.

This report will focus on the two key aspects of risk management: assuring financial controls and integrity.

Effective Risk Management Activities for Assuring Financial Control and Integrity

Effective risk management processes possess the following three elements:

- **Define the Problem.** Identify opportunity and threat outcomes, prioritize high-impact opportunity and threat outcomes, and focus the organization's efforts to produce high-impact results.

- **Manage Internal Risk.** Direct the organization's resources to produce high-impact results.
- **Evaluate and Oversee Internal Risks.** Protect the organization's resources from misuse.

Using Risk Management Processes to Manage High-Impact Outcomes

High-impact outcomes include positive or negative events that might show up on the front page of the newspaper. These outcomes may include negative events such as violence against employees or theft of the organization's resources. One generally thinks of negative outcome events when considering risk management. However, risk management also deals with positive outcome events such as excellent organizational performance. Risk management programs focus the governmental entity's efforts and resources on maximizing positive and minimizing negative high-impact outcomes.

Risk management benefits organizations by helping them maximize their high-impact opportunity outcomes and minimize high-impact threat outcomes. By implementing a risk management process, the government entity increases the likelihood that it will achieve positive high-impact opportunity outcomes and minimize negative high-impact threat outcomes.

Strategies for Managing for High-Impact Outcomes

The report divides the risk management process cycle for financial controls and integrity into three phases. Implementation of risk management activities increases the likelihood of maximizing high-impact opportunity outcomes and minimizing high-impact threat outcomes. The three phases are:

- **Phase One: Government managers *identify* opportunity and threat outcomes.** They prioritize the high-impact outcomes from the low-impact outcomes. The managers focus the organization's attention on the high-impact outcomes.
- **Phase Two: Organizations *manage resources and processes* to achieve the high-impact opportunity outcomes and minimize high-impact threat outcomes.**
- **Phase Three: Government managers *evaluate* the high-impact outcomes.** When management completes the evaluation, the process begins again.

This report explains how to systematically go through this process. The next section describes Phase One, how government managers identify high-impact outcomes using a strengths, weaknesses, opportunities, and threats (SWOT) analysis; how they prioritize outcomes using impact and likelihood analysis; and how they incorporate high-impact outcomes into mission statements and objectives to focus attention on achieving these outcomes. The section which follows discusses Phase Two and how organizations manage resources and processes to achieve positive high-impact outcomes while reducing negative high-impact outcomes, especially in the area of governmental finances and financial processes. The last section discusses how to evaluate outcome achievement in Phase Three. Figure 1 shows the tools used in each phase.

This report presents best practice examples in the context of key principles from the governmental, financial oversight, and risk management literature. It provides examples of local government best practices. It also presents financial oversight and integrity checklists that managers can use to assess their organizations.

Figure 1: Processes and Tools for Managing Risks to Assure Financial Control and Integrity

Phase	Process	Tool
One	**Define the Problem** —Identify —Prioritize —Focus	—SWOT Analysis —Impact and Likelihood Analysis —Mission and Objective Analysis
Two	**Manage Internal Risk**	Risk Management and Control Analysis
Three	**Evaluate and Oversee Internal Risks**	Outcome Assessment Analysis

Phase One: Define the Problem

Identify

Governmental entities manage their strengths, weaknesses, opportunities, and threats on a daily basis. Unfortunately, many managers do not systematically identify their opportunities and threats or their greatest strengths and weaknesses. By not using a systematic process, a government entity may fail to identify important strengths, weaknesses, opportunities, or threats. By failing to identify these areas, the organization cannot effectively manage them.

This section shows how to systematically identify the organization's strengths, weaknesses, opportunities, and threats. The organization will take a major step toward improving its high-impact outcomes when it follows the systematic identification process contained in this section.

SWOT Analysis

SWOT is an acronym for "strengths, weaknesses, opportunities, and threats." Organizations can identify high-performing internal processes and significant external influences by using a SWOT analysis. A SWOT analysis helps systematically identify and list the key strengths, weaknesses, opportunities, and threats facing the organization.

A SWOT analysis identifies the organization's internal process strengths and weaknesses. Strengths include the organization's high-performing internal processes. Weaknesses include the organization's low-performing internal processes. Opportunities include external influences that could result in positive outcomes. Threats include external influences that could result in negative outcomes.

Outcome Identification

After identifying strengths, weaknesses, opportunities, and threats, the organization then uses the list to develop an outcome identification table. The table identifies potential outcomes based on how the entity's strengths and weaknesses interact with its opportunities and threats.

Organizational strengths directed toward organizational opportunities will likely result in high-impact opportunity outcomes. The organization lists these outcomes in Quadrant 2 of Table 1. Organizational weaknesses interacting with organization threats will likely result in high-impact threat outcomes. The organization lists these outcomes in Quadrant 3. Organizational weaknesses aimed at likely opportunities will result

Table 1: Outcome Identification

INTERNAL	Strengths	*Quadrant 1* Low-Impact Threat Outcomes	*Quadrant 2* High-Impact Opportunity Outcomes
INTERNAL	Weaknesses	*Quadrant 3* High-Impact Threat Outcomes	*Quadrant 4* Low-Impact Opportunity Outcomes
		Threats	**Opportunities**
		EXTERNAL	**EXTERNAL**

SWOT Analysis Process

The organization can use several processes to collect information for a SWOT analysis. It can send questionnaires to employees, taxpayers, and other organization stakeholders, asking them to list what they believe are the strengths, weaknesses, opportunities, and threats of the organization. The organization could collect the same type of information through the organization's website. The organization can form focus groups to discuss and record these same issues.

SWOT analyses thoroughly capture and record as many strengths, weaknesses, opportunities, and threats as possible. A SWOT analysis is a brainstorming activity in which as many ideas as possible are listed without editing the results. At this point in the process, do not worry about analyzing, ranking, or prioritizing these areas. If participants sidetrack themselves by engaging in these activities at this point in time, they may hinder the free flow of ideas that is critical to a successful SWOT brainstorming activity.

After an initial SWOT analysis, the organization may want to consider regular SWOT analyses during its annual planning process.

in low-impact opportunity outcomes listed in Quadrant 4. Organizational strengths protect it from threats, resulting in low-impact threat outcomes listed in Quadrant 1. High-impact outcomes occur in Quadrants 2 and 3. Low-impact outcomes occur in Quadrants 1 and 4.

Some threat outcomes such as physical harm to employees or students, or theft of government funds, result in significant reputational damage for the organization. In these cases, organizations generally develop effective processes in an effort to prevent these events from occurring. Even with the strong processes, however, the organization may want to categorize these threat outcomes as high-impact, Quadrant 3 threat outcomes because of the significant adverse consequences if the outcome occurs. Appendix I shows examples of some high-impact opportunity and threat outcomes. Once management identifies opportunity and threat outcomes, it begins the process of prioritizing the outcomes, which is discussed in the next section.

Prioritize

Some organizations do SWOT analyses to identify their strengths, weaknesses, opportunities, and threats. Many administrators and governmental boards do not systematically prioritize these areas. By not using a systematic process, an organization may fail to effectively prioritize opportunity or threat outcomes. If the organization fails to prioritize these areas, it cannot effectively manage its high-impact outcomes.

This section shows how to systematically prioritize opportunity and threat outcomes. The organization will take a major step toward improving its high-impact outcomes when it follows the systematic prioritization process contained in this section.

Likelihood Analysis

After listing outcome events and assessing their impacts, the next step is to assess the likelihood of the outcome occurring. Management controls through policies or processes influence the likelihood of the event occurring. Effective controls increase the likelihood of achieving opportunity outcomes and preventing threat outcomes. Non-control-related factors also may contribute to the likelihood of achieving the outcomes.

Tables 2 and 3 present tools to help *prioritize* the organization's opportunities and threats. An organization can complete these tables based on information derived from the SWOT analysis while considering the effectiveness of controls and their impact on the likelihood of achieving opportunity outcomes or preventing threat outcomes. The horizontal axis in Table 2 categorizes outcomes into low or high impacts. The table's vertical axis categorizes outcomes into a low or high likelihood of the event occurring.

Quadrant 2 in Table 2 identifies high-impact opportunities with a high likelihood of occurring. These Quadrant 2 opportunity and threat outcomes are mission-critical outcomes that should become the focus of an organization's efforts.

Quadrant 2 in Table 3 identifies high-impact threats with a high likelihood of occurring. These should be the focus of an organization's threat prevention efforts.

Table 2: Opportunity Outcomes

IMPACT	**High**	*Quadrant 1*	*Quadrant 2* (Mission Critical)
	Low	*Quadrant 3*	*Quadrant 4*
		Low	**High**
		LIKELIHOOD OF OPPORTUNITY	

Table 3: Threat Outcomes

IMPACT	**High**	*Quadrant 1*	*Quadrant 2* (Threat Prevention)
	Low	*Quadrant 3*	*Quadrant 4*
		Low	**High**
		LIKELIHOOD OF THREAT	

Once managers identify the high-impact, high-likelihood opportunity and threat outcomes, they can begin setting strategic or operational objectives to deal with these risks.

Focus

The Problem with Mission Statements

The good news is that almost every organization has a mission statement. The bad news is that many organizational mission statements lack focus in three areas. First, the mission statements generally meander through a long laundry list of ideas. Second, the mission statements express a number of feelings or platitudes instead of focusing on achieving high-impact opportunities that have a high likelihood of occurring. Third, the mission statement outcomes cannot be objectively measured. Without measurable outcomes, which are discussed below, the organization cannot assess whether or not it achieved its mission.

By not communicating a focused mission and related measurable outcomes, the organization fails to provide clear guidance on where to focus the organization's resources and processes. Without focused guidance, the organization will probably not achieve its high-impact opportunity outcomes.

Objective setting is a key element of risk management. Through the proper development of a strong mission statement and related objectives, management can identify measurement criteria for performance that focus on the critical success factors of high-impact opportunity outcomes. After identifying strategic objectives in the mission statement, management should develop objectives in the areas of operations, reporting, and compliance.

This section discusses how the organization can produce a powerful mission statement and related outcomes that focus its resources and processes on achieving high-impact opportunities and avoiding high-impact threats. By developing a focused mission statement and related objectives, the organization increases the likelihood that it will achieve its high-impact opportunity outcomes and decreases its high-impact threat outcomes.

Focused Mission Statements

A focused mission statement concisely and precisely expresses the organization's mission in one or two sentences. Mission statements should focus the organization's attention on a few key outcomes critical to the organization's success. A brief mission statement has several advantages. First, a short mission statement

Best Practices: Mission Statement and Related Objectives

Strategic Planning Retreat—City of Canyon Lake, California

This document states the city's mission statement, core values, and three-year goals. It lists the results of the city's SWOT analysis. For each three-year goal, it discusses what success will look like using key performance measures. It provides six-month strategic objectives on how the goals will be accomplished, including what will be accomplished, who is responsible, and when it will be accomplished.

Source: *www.cityofcanyonlake.com/uploads/files/strategic-plan-final.pdf*

forces the organization to carefully define its most important high-impact outcomes. Second, a short mission statement focuses the organization's resources and processes on its most important high-impact outcomes. Third, people can remember mission statements that are a sentence or two. They are more likely to focus their efforts to achieve these outcomes when they can remember them.

Focused mission statements express high-impact opportunities that have a high likelihood of occurring. The first sentence of a mission statement often summarizes the high-impact opportunity outcomes the organization strives to achieve. The second sentence of a mission statement often states the high-impact threats the organization wants to avoid. However, many organizations prefer to keep the focus of their mission statements on achieving opportunity outcomes.

Powerful mission statements contain outcomes with understandable and measurable results. Measurement allows one to assess the organization's progress on high-impact outcomes. Measurement lets one know when the organization achieves its mission. Organizations should develop measurable metrics of their mission statement outcomes. These mission-related measurable outcomes become the major strategic objectives of the organization.

The organization should prepare contingency plans for high-impact threats that have a low likelihood of occurring. Generally, low-impact opportunities do not require specific documentation. Table 4 presents the documents that focus on high-impact opportunities and threats.

Table 4: Documentation

HIGH IMPACT		LIKELIHOOD: Low	LIKELIHOOD: High
	Opportunities	*Quadrant 1*	*Quadrant 2* Mission Statement and Related Outcomes
	Threats	*Quadrant 3* Contingency Plan and Related Outcomes	*Quadrant 4* Mission Statement (Optional) and Related Outcomes

Phase Two: Manage Internal Risk

Management's risk philosophy and risk appetite will impact the organization's response to risk. According to the Enterprise Risk Management—Integrated Framework, a risk management philosophy includes the shared values, beliefs, and attitudes of the organization that influence its culture, operating style, and risk management processes. Policies, communications, and actions emphasize and reinforce the organization's risk management philosophy. The risk management philosophy influences risk appetite, which is the amount of broad-level risk acceptable to achieve opportunities or minimize threats. Organizations should consider their risk philosophy and appetite as they consider the framework's four strategies for responding to risks:

- **Acceptance.** Organizations may choose to accept risk. When accepting risks, the organization chooses to do nothing with the risk. It may decide that the cost of managing the risk exceeds the benefits. The organization may choose to accept risks for low-impact opportunities or threats. Accepted risks require no further management action.
- **Avoidance/Eliminate.** Organizations may decide to avoid the risk by eliminating the activity. It may eliminate the activity associated with the risk because the costs of the activity exceed the benefits. The organization may choose to eliminate activities associated with low-impact opportunities that have a low likelihood of occurring. It also may want to eliminate activities that lead to high-impact threats with a high likelihood of occurrence. Eliminated risks require no further management action.
- **Sharing/Transfer.** Organizations may choose to share risk by transferring it. The organization may decide to transfer risk by outsourcing activities that result in low-impact opportunities. It also can transfer risk by acquiring insurance for high-impact threats. The organization should consult with experts in outsourcing or insurance to evaluate the cost and benefits of using these approaches for selected activities.
- **Reduction/Control.** Organizations may choose to reduce the risk of achieving high-impact opportunities or avoiding high-impact threats. It may implement control activities designed to maximize high-impact opportunities or to minimize high-impact threats. The remainder of this report focuses on financial control and integrity activities which management and boards may implement to increase the likelihood of achieving high-impact opportunities or avoiding high-impact threats, especially with financial processes.

Table 5 (page 12) summarizes risk management methods based on the impact and likelihood for opportunity outcomes. Management generally controls high-impact opportunity outcomes with both low and high likelihoods of occurrence. For low-impact opportunity outcomes with high and low likelihood of occurrence, management generally accepts or transfers the risk through outsourcing. Management also may consider eliminating low-impact opportunity outcomes with a low likelihood of occurrence.

Table 6 (page 12) summarizes risk management methods based on the impact and likelihood for threat outcomes. Management generally eliminates or accepts low-impact outcomes with low and high likelihoods of occurrence. They generally eliminate or transfer risk by acquiring insurance for high-impact outcomes for both low- and high-likelihood

Table 5: Opportunity Outcome Risk Management

IMPACT		Low (Likelihood of Opportunity)	High (Likelihood of Opportunity)
IMPACT	High	*Quadrant 1* Control	*Quadrant 2* Control
IMPACT	Low	*Quadrant 3* Eliminate, Accept, or Transfer	*Quadrant 4* Accept or Transfer
		Low	**High**
		LIKELIHOOD OF OPPORTUNITY	

Table 6: Threat Outcome Risk Management

IMPACT		Low (Likelihood of Threat)	High (Likelihood of Threat)
IMPACT	High	*Quadrant 1* Eliminate or Transfer	*Quadrant 2* Control, Eliminate, or Transfer
IMPACT	Low	*Quadrant 3* Eliminate or Accept	*Quadrant 4* Eliminate or Accept
		Low	**High**
		LIKELIHOOD OF THREAT	

occurrences. They generally also establish controls for high-impact threat outcomes with a high likelihood of occurrence.

The previous section described processes for evaluating the impact, likelihood, and general responses to overall risk. The following sections cover internal control responses the organization may consider for many high-impact and high-likelihood threats related to the financial operations of the organization.

Financial Controls: Reporting, Internal Control, and Compliance

The Committee of Sponsoring Organizations of the Treadway Commission issued its Internal Control—Integrated Framework in 1992. According to the framework, effective internal controls provide a reasonable assurance of an organization's compliance with regulations and laws, the reliability of its financial statements, and the achievement of its organizational objectives. Organizations can apply risk management and internal controls to any objectives within their organization. This report focuses mainly on the application of these principles to finance-related objectives and controls.

Effective internal controls provide a strong foundation for audits of public organizations. Under the Single Audit Act, which is applicable to many local governmental audits, the external auditor evaluates and provides reports on the organization's financial statements, internal controls, and compliance with laws and regulations. Strong internal controls reduce the risk of problems in all three of these areas. This section discusses how to effectively apply key elements of the internal control environment framework to governmental organizations.

Management, the board, and the audit committee, where applicable, should provide proper oversight of financial reporting, internal control, and compliance issues. Prior to the release of the audited financial report, the board and its audit committee should review and discuss the reports discussed in this section with management, the internal auditor, and the independent auditor.

Management, the board, and the audit committee should review a draft of the annual audited financial statements—including related disclosures and the draft independent auditor report. They should discuss the significant financial reporting issues and judgments used by the organization, as well as any alternative financial reporting principles and practices that the organization could have used. They also should discuss the financial impact of the selected accounting principles and practices versus the alternatives. Management, the board, and the audit committee should discuss significant accounting estimates and changes in accounting principles. They should review any disagreements between the administration and the auditors over financial reporting issues. They also should review any difficulties encountered during the audit, including restrictions on access to requested information or on the scope of the audit. Management, the board and the audit committee should review the auditor procedures and results related to the American Institute of Certified Public Accountants' (AICPA's) Statement on Auditing Standards No. 99—Consideration of Fraud in a Financial Statement Audit.

Management, the board, and the audit committee should review the risk assessment of the organization's fiscal operations developed under governmental auditing standards for a financial statement audit and federal single audit standards, if applicable. They should review the administration's internal control report on the effectiveness of the organization's internal control structure for financial reporting, as well as a draft of the auditor's report on internal controls. They should discuss the adequacy and effectiveness of internal controls, including computerized information system controls and security. They also should review the draft management letter provided by the independent auditor as well as other internal control findings and recommendations by auditors and the administration's response.

Small organizations possess internal control characteristics that require special attention. Because of their lack of complexity, smaller organizations might rely heavily on entity-level controls to achieve some of their control objectives. Since senior administrators are involved in the day-to-day operations of the organization, these managers may have more opportunities to override the controls or misstate financial statements. Smaller organizations have fewer employees, making it difficult to segregate the incompatible duties of authorizing transactions, maintaining custody of assets, record keeping, and reconciliation. They may need to use alternative approaches to the segregation of duties to achieve their control objectives. Smaller organizations should consider the effectiveness of their application controls for unmodified off-the-shelf software. They also may struggle to maintain financial reporting competencies internally, requiring them to outsource this activity. In certain areas, smaller organizations may have less formal audit documentation.

Management, the board, or its audit committee should review and discuss the organization's compliance with laws and regulations. They should assess reports, inquiries, or correspondence from governmental or regulatory agencies that raise material financial reporting issues. They should review employee complaints and published reports that raise material financial reporting issues. They also should review compliance with the organization's codes of conduct for employees, senior financial officers, and contractors.

Prior to the release of the audited financial report, the board and its audit committee should discuss with the independent auditors matters required to be discussed by AICPA's Statement on Auditing Standards No. 114—The Auditor's Communication With Those Charged With Governance. They also should discuss with the administration and the organization's legal counsel the status of significant legal and regulatory matters that could have a material impact on the organization's financial statements, related organization compliance policies and practices, and reports received from regulators.

Management, the board, and the audit committee should review and discuss the coordination of audits among the internal auditor, independent auditor, and controller to achieve a completeness of coverage, the reduction of redundant efforts, and an effective use of audit resources.

Action

Exhibit 1 (page 14) presents a financial reporting, internal control, and compliance checklist. Management, the board, and the audit committee should use this checklist to assess their financial reporting, internal control, and compliance processes. Management and the board should require corrective action where deficiencies exist.

Exhibit 1: Financial Reporting, Internal Control, and Compliance Checklist

Organization Name: ____

Completed by: ______________________________ Date: ______________

	Financial Reporting, Internal Control, and Compliance Matters	Yes	No
1.	Prior to the release of the audited financial report, the board or audit committee reviewed and discussed with management, the internal auditor, and the independent auditor the following financial reporting matters:		
a.	Draft of annual audited financial statements, including related disclosures		
b.	Draft of independent auditor report		
c.	Significant financial reporting issues and judgments followed by the organization		
d.	Alternative financial reporting principles and practices that could have been followed		
e.	The financial impact of selected principles and practices versus alternatives		
f.	Significant changes in accounting principle(s)		
g.	Significant accounting estimates		
h.	Any disagreements between management and the auditors about financial reporting		
i.	Any difficulties encountered during the audit, including restrictions on access to requested information or on the scope of the audit		
j.	Auditor procedures and results related to AICPA's Statement of Auditing Standards No. 99—Consideration of Fraud in a Financial Statement Audit		
2.	Prior to the release of the audited financial report, the board or audit committee reviewed and discussed with management, the internal auditor, and the independent auditor the following risk and internal control matters:		
a.	Any risk assessment of the organization's fiscal operations developed under governmental auditing standards for a financial statement audit and federal single audit standards, if applicable		
b.	Management's internal control report on the effectiveness of the organization's internal control structure for financial reporting		
c.	Auditor's draft of the internal control report		
d.	Adequacy and effectiveness of internal controls, including computerized information system controls and security		
e.	Draft management letter provided by the independent auditor as well as other internal control findings and recommendations by auditors, and the administration's response		
f.	Small organization internal control considerations: • Entity-level controls • Management override risk • Segregation of duties—Alternative controls • Software application controls • Financial reporting competencies • Documentation		
3.	Prior to the release of the audited financial report, the board or audit committee reviewed and discussed with management, the internal auditor, and the independent auditor the following compliance matters:		
a.	Compliance with applicable laws and regulations		
b.	Material reports, inquiries, or correspondence from governmental or regulatory agencies that raise material financial reporting issues		
c.	Employee complaints or published reports that raise material financial reporting issues		

	Financial Reporting, Internal Control, and Compliance Matters	Yes	No
d.	Compliance with the organization's codes of conduct for employees, senior financial officers, and contractors		
4.	Prior to the release of the audited financial report, discussed with the independent auditor matters required to be discussed by AICPA's Statement of Auditing Standards No. 114—The Auditor's Communication With Those Charged With Governance		
5.	Prior to the release of the audited financial report, the board discussed with management and the organization's legal counsel the following:		
a.	Status of significant legal and regulatory matters that could have a material impact on the organization's financial statements		
b.	Related organization compliance policies and practices		
c.	Reports received from regulators		
6.	The board reviewed and discussed with management, the internal auditor, and the independent auditor the coordination of audits among internal auditor, independent auditor, and controller to achieve the following audit objectives:		
a.	Completeness of coverage		
b.	Reduction of redundant efforts		
c.	Effective use of audit resources		

Integrity: Management and Board Oversight

The control environment forms the foundation of a strong internal control program. Effective management and boards are critical components of the control environment. Major responsibilities of both managers and local government board members include exercising the duties of loyalty and care. Local governments often have a variety of governing entities, such as city councils, school boards, park boards, and other oversight boards.

Managers and local government board directors owe a duty of loyalty to the organization. Loyal managers and directors avoid conflicts of interest. For example, they do not participate in matters where they have a personal interest. Loyal managers and directors always act in good faith in the interests of the organization.

The duty of loyalty protects a governmental organization by requiring managers and board members to put the organization's interests ahead of their own individual interests. The organization can improve the duty of loyalty of managers and board members by encouraging them to ethically lead the organization through example, policies, and communications—and by insisting that they avoid conflicts of interest. Board members also should maintain independence from management by not managing the organization.

Managers and board directors owe a duty of care to their organizations. Managers and directors exercise care by acquiring information about the organization through a reliance on others and through inquiry, especially when a concern arises. Managers and directors exercise care by preparing themselves for meetings. They also allocate sufficient time for their duties and attend all required meetings. They should exercise the level of care expected of a reasonable manager or board member.

The duty of care benefits the organization by requiring managers and board members to exercise reasonable care while fulfilling their duties. The organization can improve the duty of care among managers and board members by improving their competency through adequate training and experience, encouraging adherence to the "reasonable person" standard, and insisting on preparation for and attendance at meetings.

Best Practices:
Code of Conduct for Councils and Boards

City Council Personal Code of Conduct—City of Mountain View, California
The code of ethics encourages public confidence in the local government, as well as in its effective and fair operation. City council members sign the code, affirming that they read and understand it.

Source: *www.ci.mtnview.ca.us/city_council/council_code_of_conduct/personal_code_of_conduct.asp*

Code of Conduct for Members of Boards—Illinois Association of Boards
This code of conduct establishes principles and standards of conduct for members of local boards so that they represent the public interest in education.

Source: *www.iasb.com/pdf/issue5.pdf*

Conflict of Interest Disclosure—Dallas Independent School District
The school district's website provides a brief biography for each member of the Board of Trustees. A link is made to a copy of the original conflict of interest disclosure signed by the trustee, which includes a disclosure of substantial interest in a business entity.

Source: *www.dallasisd.org/about/boardbiodist2.htm*

Generally, litigation involving managers and board directors challenges the duty of loyalty rather than the duty of care. Conflicts of interest involving the personal interests of managers or directors and not acting in good faith expose them to personal liability. Managers and directors can minimize the potential for personal liability by acting in good faith, avoiding conflicts of interest, and making reasonable informed decisions for their organization.

Distinct Governance Responsibilities of Managers and Local Government Boards

State laws safeguard organizations by requiring the election of board members to provide oversight for the organization. The public holds these individuals responsible, and the public may replace them if they do not do their duties as perceived by the public.

The independent oversight of the board guards the organization by limiting the power of one or a few administrators or board members. No individual or small group of individuals should have unfettered decision-making powers. Boards generally appoint, replace, and set the compensation for the chief operating officer, establish polices to direct the individual's actions, and review the person's performance.

This separation of powers protects the organization by segregating the board oversight role from the management role. Board members should provide independent oversight and approve all major financing and investing activities of the organization. Board members should not perform management functions.

Action
Exhibit 2 contains a management and board oversight checklist that includes many of the key concepts contained in this section. Managers and boards should use this tool to evaluate themselves, and they should require corrective action where deficiencies exist.

Integrity: Implementing Codes of Conduct or Ethics

The control environment establishes the foundation for the ethical tone of the organization. Ethical values and integrity form the cornerstone for the foundation of the control environment. The Yellow Book government auditing standards used to audit governmental organizations provide a concise summary of setting the tone for ethical behavior:

> Management of the audit organization sets the tone for ethical behavior throughout the organization by maintaining an ethical culture, clearly communicating acceptable behavior and expectations to each employee, and creating an environment that reinforces and encourages ethical behavior throughout all levels of the organization. The ethical tone maintained and demonstrated by management and staff is an essential element of a positive ethical environment for the audit organization. (Government Auditing Standards, July 2007).

Exhibit 2: Management and Board Oversight Checklist

Organization Name: ____________________

Completed by: ____________________ Date: __________

	Duty of Loyalty	Yes	No
1.	Managers and board members ethically lead the organization by example.		
2.	Managers and board members ethically lead the organization through effective policies.		
3.	Managers and board members ethically lead the organization through effective communications.		
4.	Managers and board members always put the organization's interests ahead of their own personal interests.		
5.	Managers and board members ethically lead the organization through the avoidance of conflicts of interest.		
6.	Managers and board members ethically lead the organization by not participating in matters in which they have a personal interest.		
7.	Managers and board members always act in good faith in the interests of the organization.		
8.	Board members always maintain independence from management.		
	Duty of Care		
1.	Managers and board members acquire information about the organization through a reliance on others and through inquiry.		
2.	Managers and board members adequately prepare for meetings.		
3.	Managers and board members attend almost all meetings.		
4.	Managers and board members exercise reasonable care while fulfilling their duties.		
5.	Managers and board members adhere to the reasonable person standard.		
6.	Management board members are adequately trained to meet their responsibilities.		
	Administrator Oversight		
1.	The board appoints, replaces, and sets the compensation for the chief operating officer.		
2.	The board establishes policies to direct the chief operating officer's actions.		
3.	The board reviews the chief operating officer's performance.		
4.	The board approves all major financing and investing activities of the organization.		
5.	The board provides effective oversight of the administrative function.		
6.	The board does not perform management functions.		

Best Practices: Ethics Office

Ethics Office—Los Angeles Unified School District, California
The Los Angeles Unified School District Ethics Office provides excellent guidance for the development of ethics-related documents and training. It provides information and online ethics training for employees, board members, parents, students, contractors, and lobbyists. It also publishes excellent codes of ethics for employees and contractors.

Source: *http://ethics.lausd.net/*

Ethics Office—City of Jacksonville, Florida
The City of Jacksonville's ethics webpage provides the telephone number for the ethics hotline. It includes an ethics training video and provides links to ethics information for lobbyists and procurement.

Source: *www.coj.net/Departments/Ethics+Office/default.htm*

Management can communicate ethical expectations by establishing an ethics officer and office to communicate and monitor ethical conduct within the organization.

Managers should develop strong ethical standards for their organization, and should abide by the standards. Codes of conduct communicate these standards to employees, board members, volunteers, and contractors—which includes suppliers. The organization should train board members, volunteers, and employees on the expectations contained in its code of conduct. The organization should require everyone to sign a statement that they read the code, understand it, and that they will abide by the code's expectations. Codes should apply to all board members and organization employees. The organization also should establish separate codes for senior financial officers and for those who supply services, goods, or construction for the organization.

Codes of conduct that apply to all organization employees, board members, and volunteers should briefly summarize expectations of civil conduct toward others. For example, the code of conduct should include a summary of sexual harassment policies. For a school district, the code should cover topics of child abuse and inappropriate relationships or discussions with students. The code should prohibit the use of organization assets for personal use. It should prohibit conflicts of interest. The code also should contain information regarding whom to contact to report violations of the code or to ask questions concerning it or its application.

Section 406 of the Sarbanes-Oxley Act requires a code of ethics for senior financial officers. Codes of conduct for senior financial officers should apply to the organization's principal financial officer, principal accounting officer, or persons performing similar

Best Practices: Code of Conduct for Employees

Employee Code of Conduct—City of St. Louis, Missouri
This code of conduct applies to all city employees appointing authorities, supervisors, and employees. The code provides guidance regarding nondiscrimination, confidential information, political activities, conflicts of interest, relationships, gifts, kickbacks, secret commissions, bribes, payoffs, and reporting fraud. Employees and their supervisors must sign an acknowledgement of the code.

Source: *http://stlouis.missouri.org/citygov/personnel/cccs.pdf*

Employee Code of Ethics—Los Angeles Unified School District, California
This code of ethics applies to all district personnel and the school board. It states whom to contact for ethical advice, help, and training. The code provides detailed guidance on commitment to excellence, personal integrity, and responsibility. It provides sources for additional information.

Source: *http://ethics.lausd.net/FTP/Employee_Code_of_Ethics.pdf*

Code of Ethics for Directors, Officers, and Employees—New York City Municipal Water Finance Authority
This code promotes ethical and honest conduct, addresses conflicts of interest, and addresses disclosures in financial reports.

Source: *http://home2.nyc.gov/html/nyw/pdf/nyw_amended_ethics_guidelines.pdf*

Code of Official Conduct—District of Columbia
The code covers misconduct, conflict of interest, corruption, criminal activity, and the use of employees for personal services.

Source: *www.dcwatch.com/council18/conduct.htm*

Best Practices: Code of Ethics for Government Finance Officers

Code of Ethics—City of Danville, Illinois
This code of ethics covers personal standards of honor and integrity, responsibilities as public officials, professional development, information integrity, professional relationship integrity, and conflicts of interest.

Source: *www.cityofdanville.org/index.php?cID=76*

functions. According to Section 406, the code of ethics is the set of standards reasonably necessary to promote:

1. Honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
2. Full, fair, accurate, timely, and understandable disclosure in the periodic reports required to be filed…; and
3. Compliance with applicable governmental rules and regulations.

Organizations should include the above expectations in their codes of ethics for senior financial officers.

Supplier or contractor codes of conduct may contain specific requirements regarding the use of labor, health and safety, environmental issues, management practice, and ethical conduct.

Action
Exhibit 3 (page 20) provides a code of conduct checklist that organizations can use to evaluate the sufficiency of their codes of conduct. Both management and boards should use this checklist to assess their codes of conduct. Management and boards should require corrective action where deficiencies exist.

Integrity: Effective Ethics and Compliance Programs

Effective ethics and compliance programs improve the reputation of an organization. Effective compliance programs can minimize losses in potential litigation. These programs also can reduce the risk and punishment related to criminal behavior. Proper responses to misconduct can also mitigate penalties for the misconduct. The following sections discuss each of these areas.

Management and boards should review actions on compliance findings and the compliance system environment with legal counsel. They should review the state of workplace safety, employee relations, and environmental compliance. Management and the board should also review the conformity of the organization's compliance and ethics program with the Federal Sentencing Guidelines.

Best Practices: Code of Conduct for Contractors

Contractor Code of Conduct—Los Angeles Unified School District, California
This code of conduct establishes extensive ethical requirements and standards for all the organization's contractors and their representatives.

Source: *http://ethics.lausd.net/FTP/Contractor_Code_of_Conduct.pdf*

Code of Conduct for Vendors—University of Michigan, Ann Arbor, Michigan
This code of conduct promotes human rights, labor standards, and a safe and sustainable environment.

Source: *www.vpcomm.umich.edu/pa/key/pdf/VendorCode.pdf*

Federal Sentencing Guidelines

Effective ethics and compliance programs can significantly reduce risk exposures for organizations. The Federal Sentencing Guidelines provide excellent guidance for establishing and maintaining effective compliance and ethics programs. These guidelines require organizations to meet minimal ethical and compliance standards in seven key areas: standards and procedures, board and management oversight, assignment of personnel, communications, monitoring, enforcement, and responses to criminal misconduct.

Federal courts can hold organizations that receive federal funding criminally liable for the fraudulent

Exhibit 3: Code of Conduct Checklist

Organization Name: ______________________________

Completed by: ______________________________ Date: ______________

	Code of Conduct for Employees, Board, and Volunteers	Yes	No
1.	The organization established a code of conduct for the employees, board, and volunteers.		
2.	The code summarizes expectations of civil conduct towards others, including sexual harassment policies.		
3.	The code summarizes policies on child abuse and inappropriate relationships or discussions with students. (For school districts only)		
4.	The code prohibits the use of organization assets for personal use.		
5.	The code prohibits conflicts of interest.		
6.	The code includes contact information to report code violations or to ask questions regarding the application of the code.		
7.	All board members, employees, and volunteers participated in training on the code.		
8.	All board members, employees, and volunteers signed a statement that they read and understand the code, and that they will abide by its expectations.		
	Code of Conduct for Senior Financial Officers		
1.	The organization established a code of conduct for senior financial officers.		
2.	The code of conduct addresses ethics for the organization's principal financial officer, principal accounting officer, or persons performing similar functions.		
3.	The code of conduct requires honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships.		
4.	The code of conduct requires full, fair, accurate, timely, and understandable disclosure in the periodic reports required to be filed.		
5.	The code of conduct requires compliance with applicable governmental rules and regulations.		
6.	All of the organization's principal financial officers, principal accounting officers, or persons performing similar functions signed a statement that they read and understand the code, and that they will abide by its expectations.		
	Code of Conduct for Contractors/Suppliers		
1.	The organization established a code of conduct for contractors/suppliers.		
2.	The code contains specific requirements regarding use of labor, health and safety, environmental issues, management practice, and ethical conduct.		
3.	All contractors signed a statement that they read and understand the code, and that they will abide by its expectations.		
	Code of Conduct for Students (For school districts only)		
1.	The organization established a student code of conduct.		

use of federal funds. For example, organizations could face federal criminal charges under the federal sentencing guidelines if an employee violates federal law to financially benefit the organization. Organizations could also face fines under the Federal Sentencing Guidelines for criminal violation of federal employment or discrimination laws. The Federal Sentencing Guidelines represent the best practices for establishing and implementing effective compliance and ethics programs. Many organizations use the Federal Sentencing Guidelines as the foundational principles for their compliance programs.

Action

The Federal Sentencing Guidelines provide excellent guidance for governmental organizations on compliance and ethics programs. Exhibit 4 (page 22) presents a compliance and ethics program checklist for organizations. The checklist is derived from the Federal Sentencing Guidelines for effective compliance and ethics programs. Management and the local government board members should use this checklist to assess the effectiveness of the organization's compliance and ethics program. The board should require corrective action where deficiencies exist.

Integrity: Responding to Misconduct

The Securities and Exchange Commission (SEC) issued the Seaboard Criteria, describing the best practices for organizations responding to misconduct. The SEC decided to take no punitive action against an organization because of the organization's response to the misconduct. While not subject to the Seaboard Criteria, government management and boards would benefit from considering the SEC Seaboard Criteria when evaluating the response to misconduct within their organizations.

The criteria consider whether the misconduct resulted from simple negligence, reckless or deliberate indifference, willful misconduct, or unadorned venality. The criteria address whether or not the independent auditor was misled. The criteria consider whether or not the board and senior management set a tone of lawlessness for the organization and had proper compliance procedures in place to prevent the misconduct. They cover senior management's possible involvement in the misconduct or turning a blind eye to the misconduct. The criteria also consider the systematic nature of the misconduct over a period of time, and whether or not the misconduct is symptomatic of the way the organization does business.

The criteria evaluate the administration and board's response to the misconduct. They consider whether the persons responsible for the misconduct are still with the organization, and if so, whether they remain in the same position. The criteria also deal with management's detection of misconduct in a timely manner, consultation with legal counsel, and the taking of appropriate steps to stop the misconduct in a timely manner after learning of the misconduct.

The criteria discuss prompt, complete, and effective disclosure of the misconduct to regulators and to the public as well as complete cooperation with appropriate regulatory and law enforcement bodies. The board and the audit committee should be fully informed in a timely manner and oversee the review of the misconduct. The organization should produce a thorough and probing written report detailing the findings of its review. It should also implement new and more effective internal controls to prevent recurrence of the misconduct.

Action

Exhibit 5 (page 23) presents a list of questions to assess responding to misconduct. Management and the board should require corrective action where deficiencies exist.

Best Practices: Responding to Misconduct

Reporting Governmental Misconduct—Longview School District, Washington

The policy and regulation encourages the reporting of improper government action by a school district employee or officer. It prohibits retaliatory actions against employees who follow the policy and related procedures.

Source: *www.longview.k12.wa.us/policy/5241.pdf*

Exhibit 4: Compliance and Ethics Program Checklist

Organization Name: ____

Completed by: ______________________________ Date: ______________

		Yes	No
1.	Has the organization established standards and procedures to prevent and detect criminal conduct?		
2.	Are board members knowledgeable about the content and operation of the compliance and ethics program?		
3.	Do board members exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program?		
4.	Do high-level personnel of the organization ensure that the organization has an effective compliance and ethics program?		
5.	Are specific individual(s) within high-level personnel assigned overall responsibility for the compliance and ethics program?		
6.	Are specific individual(s) within the organization delegated day-to-day operational responsibility for the compliance and ethics program?		
7.	Do individual(s) with operational responsibility report periodically to high-level personnel and, as appropriate, to the board, or to an appropriate subgroup of the board, on the effectiveness of the compliance and ethics program?		
8.	Are the individual(s) with operational responsibility given adequate resources, appropriate authority, and direct access to the board or to an appropriate subgroup of the board?		
9.	Does the organization use reasonable efforts not to include within the substantial authority personnel of the organization any individual whom the organization knew, or should have known through the exercise of due diligence, has engaged in illegal activities or other conduct inconsistent with an effective compliance and ethics program?		
10.	Does the organization take reasonable steps to communicate periodically and in a practical manner its standards and procedures, and other aspects of the compliance and ethics program to the members of the board, high-level personnel, substantial authority personnel, the organization's employees, and, as appropriate, the organization's agents?		
11.	Does the organization conduct effective training programs and otherwise disseminate information appropriate to the respective roles and responsibilities of members of the board, high-level personnel, substantial authority personnel, the organization's employees, and, as appropriate, the organization's agents?		
12.	Does the organization take reasonable steps to ensure that the organization's compliance and ethics program is followed, including monitoring and auditing to detect criminal conduct?		
13.	Does the organization take reasonable steps to evaluate periodically the effectiveness of the organization's compliance and ethics program?		
14.	Does the organization take reasonable steps to have and publicize a system, which may include mechanisms that allow for anonymity or confidentiality, whereby the organization's employees and agents may report or seek guidance regarding potential or actual criminal conduct without fear of retaliation?		
15.	Is the organization's compliance and ethics program promoted and enforced consistently throughout the organization through appropriate incentives to perform in accordance with the compliance and ethics program?		
16.	Is the organization's compliance and ethics program promoted and enforced consistently throughout the organization through appropriate disciplinary measures for engaging in criminal conduct and for failing to take reasonable steps to prevent or detect criminal conduct?		
17.	Does the organization take reasonable steps to respond appropriately to criminal conduct after it has been detected and to prevent further similar criminal conduct, including making any necessary modifications to the organization's compliance and ethics program?		
18.	Does the organization periodically assess the risk of criminal conduct and take appropriate steps to design, implement, or modify each of the above processes to reduce the risk of criminal conduct?		
19.	Does the organization promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law?		
20.	Does the organization promote an organizational culture that exercises due diligence to prevent and detect criminal contact?		

Exhibit 5: Responding to Misconduct Checklist

Organization Name: ______________________________

Completed by: ______________________________ Date: ______________

		Yes	No
1.	Did the misconduct result from simple negligence, reckless or deliberate indifference to signs of wrongful conduct, willful misconduct, or unadorned venality? If yes, circle the cause of misconduct.		
2.	Were the organization's auditors misled?		
3.	Is the misconduct the result of pressure placed on employees to achieve specific results?		
4.	Is the misconduct a result of a tone of lawlessness set by those in control of the organization?		
5.	Did high-level personnel participate in, or turn a blind eye toward, obvious signs of misconduct?		
6.	Is the misconduct part of a systemic problem?		
7.	Is the misconduct symptomatic of the way the organization does business?		
8.	Did the misconduct occur over a period of time?		
9.	Did the misconduct inflict harm on the public?		
10.	Are the persons responsible for any misconduct still with the organization?		
11.	If the persons responsible for the misconduct are still with the organization, are they in the same position?		
12.	Did the organization consult with legal counsel about the misconduct?		
13.	Did the organization have compliance procedures in place to prevent the misconduct?		
14.	Did the organization fail to detect the misconduct in a timely manner?		
15.	Did the organization effectively respond to the misconduct in a timely manner?		
16.	Did the organization take appropriate steps to stop the misconduct after learning of the misconduct?		
17.	Did the organization promptly, completely, and effectively disclose the existence of the misconduct to regulators and to the public?		
18.	Did the organization cooperate completely with the appropriate regulatory and law enforcement bodies?		
19.	Did the organization identify what additional related misconduct is likely to have occurred?		
20.	Did the organization take steps to identify the extent of damage to taxpayers and other organization constituencies?		
21.	Did the company use effective processes to resolve the issues and ferret out necessary information?		
22.	Was the board—and the audit committee, if applicable—fully informed in a timely manner?		
23.	Did the organization commit to learn the truth, fully and expeditiously?		
24.	Did the organization do a thorough review of the nature, extent, origins, and consequences of the conduct and related behavior?		
25.	Did the board or audit committee oversee the review?		
26.	Did the organization promptly make available to law enforcement the results of its review and provide sufficient documentation reflecting its response to the situation?		
27.	Did the organization identify possible violative conduct and evidence with sufficient precision to facilitate prompt enforcement actions against those who violated the law?		
28.	Did the organization produce a thorough and probing written report detailing the findings of its review?		
29.	Did the organization ask its employees to cooperate with law enforcement and make all reasonable efforts to secure such cooperation?		
30.	Did the organization adopt and ensure enforcement of new and more effective internal controls and procedures designed to prevent a recurrence of the misconduct?		
31.	Did the organization provide the auditors and the board—and the audit committee, if applicable—with sufficient information for it to evaluate the organization's measures to correct the situation and ensure that the conduct does not recur?		

Phase Three: Evaluate and Oversee Internal Risk

Management and the local government board members evaluate the effectiveness of the risk management program. They can rely on the following three important groups to help them evaluate the organization's accounting and auditing outcomes and processes:

- The independent auditor
- The internal auditor
- The audit committee

This section describes how each of these three groups provides information and helps management and the board with their oversight responsibilities.

Independent Auditor

The independent auditor assists management and the board by performing audits and reporting on the fair presentation of the annual financial statements. The independent auditor also assists management and the board with their fiduciary duty by reporting on the effectiveness of internal controls and the organization's compliance with laws and regulations. This section discusses how management, boards, and audit committees can improve the effectiveness of the independent audit function.

Auditing standards require auditors to be independent from the organizations they audit in order to avoid actual or perceived conflicts of interest. Boards and audit committees can improve the independent status of the external auditors by approving or reviewing the appointment, dismissal, and compensation of the independent auditor. The board needs to make it clear to all parties involved that the independent auditor reports to the board and/or the audit committee and not to management. This reporting channel decreases the risk that management might restrict the flow of information from the auditors to the board or the audit committee.

Management and the board can also promote independence by reviewing and discussing the independent auditor's written statement describing all relationships between the auditor and the organization. Management, the board, and the audit committee should also discuss with the independent auditor any relationships or services that may impair the independence or objectivity of the auditor. The board should approve all audit and non-audit work performed by the independent auditor.

Management, the board, and the audit committee can promote independence by reviewing the rotation of audit partners so that neither the lead nor the reviewing audit partner performs audit services for the organization for more than five consecutive years. This process ensures that individuals with fresh perspectives participate in the audit.

The board or audit committee improves independence by examining the policies for the hiring of present or former employees of the independent auditor during the preceding five years. Auditors may not perform their duties with the proper degree of skepticism if they are dealing with former employees of their firm.

The board or audit committee should assess the quality of the audit firms. It should review and discuss the report of the independent auditor's internal quality control procedures, as well as material issues raised by peer or quality review or governmental or professional authorities during the preceding five years. It also should review and discuss the steps the independent auditor took to deal with quality issues.

The board or audit committee should review the qualifications and experience of the senior members of the audit team. It also should review the performance of the external auditor, including the lead audit partner.

Changing auditors costs the organization in terms of the time and participation it takes to hire a new auditor and get it familiarized with the organization. While fresh perspectives can benefit the organization, constant changes in independent auditors may impact audit quality. The organization should consider requesting auditors to bid on audits for a three-year period. This helps prevent auditors from "low-balling," wherein they underbid for the first-year audit, hoping to make up for the low fees by charging more in subsequent years. A three-year contract improves the audit quality in the first year of the audit, when auditors need additional time to familiarize themselves with the organization and its processes, because the audit firm will receive three years of revenue to make up for the extra first-year costs. The board or audit committee should request that individuals who will actually work on the audit provide the presentations to the board or audit committee.

The board or audit committee should review and discuss with the independent auditor the audit plan and significant changes to the plan. It should discuss the independent auditor's plan to address AICPA's Statement on Auditing Standards No. 99—Consideration of Fraud in a Financial Statement Audit. It also should discuss the items on the Financial Reporting, Internal Control, and Compliance checklist (Exhibit 1, page 14) with the independent auditor and review the management representation letter. It should discuss with the independent auditor any disagreements with management, consultations with other independent auditors, major issues discussed with management prior to retention, and any significant deficiencies or material weaknesses in internal control. The board or audit committee also should discuss the discovery of fraud or illegal activities.

Action

Exhibit 6 (page 26) presents an independent auditor checklist. The board or audit committee should use this checklist to assess the independence and performance of the independent auditor. Management and the board should require corrective action where deficiencies exist.

Internal Auditor

Internal auditors assist management and the board in monitoring internal control processes. The internal auditors primarily focus on assessing the effectiveness of internal controls and monitoring the organization's compliance with laws and regulations. Internal auditors generally do much more detailed analyses in these areas, uncovering more fraud than the independent auditors. They also perform audits to assess the efficiency and effectiveness of the organization's programs. This section discusses how management and the board can improve the effectiveness of the internal audit function.

The internal audit charter defines the authority and responsibility of the internal audit function. Effective internal audit charters comply with the Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors. Management, the board, and its audit committee should approve the internal audit charter and review it periodically.

The board can promote an effective internal audit function by making it independent from management. Some organizations establish independence by having the chief internal auditor report directly to the board or audit committee. Other organizations have the internal auditor reporting directly to the chief operating officer with a secondary reporting line to the board or audit committee if the chief operating officer is involved in wrongdoing or does not adequately address concerns reported by the internal auditor. This direct reporting line to the board or audit committee prevents management from blocking or filtering bad information so that only good information reaches the board. The board can also improve auditor independence by approving or reviewing the appointment or change of the senior internal auditor as well as setting the individual's compensation. These practices prevent management from retaliating against the senior internal auditor for providing information that may not reflect well on management.

Management, the board, and the audit committee should review the budget, staffing, and qualifications of the internal audit function to ensure that it has sufficient resources and expertise to do the job. Small governmental organizations may not be able to justify a full-time internal auditor. Small organizations may consider exchanging financial personnel

Exhibit 6: Independent Auditor Checklist

Organization Name: ______________________________

Completed by: ______________________________ Date: ______________

The board and audit committee:

	Qualifications of and Relationships with Independent Auditor	Yes	No
1.	Reviewed external audit policies and regulations.		
2.	Reviewed the appointment, dismissal, and compensation of the external auditor.		
3.	Reviewed and discussed independent auditor's written statement describing all relationships between the auditor and the organization, and discussed with independent auditor any relationships or services that may impair the independence or objectivity of the auditor.		
4.	Reviewed and discussed the report of the independent auditor's internal quality control procedures, material issues raised by peer or quality review or governmental or professional authorities during the preceding five years, and steps taken to deal with the quality issues.		
5.	Reviewed the rotation of audit partners so that neither the lead nor the reviewing audit partner performs audit services for the organization for more than five consecutive years.		
6.	Reviewed and discussed the qualifications and experience of the senior members of the independent auditor's team.		
7.	Reviewed policies for the hiring of present or former employees of the independent auditor during the preceding five years.		
	Independent Audit Planning		
1.	Reviewed and discussed the scope of all auditing and non-auditing services provided by the independent auditor prior to the performance of the work.		
2.	Discussed auditor's plan to address AICPA's Statement on Auditing Standards No. 99—Consideration of Fraud in a Financial Statement Audit.		
	Discussions with Independent Auditors		
1.	The board or board chair held discussions in separate meetings with the independent auditor, management, and the internal auditor.		
2.	Discussed with the independent auditor the items on the Financial Reporting, Internal Control, and Compliance Checklist (Exhibit 1, page 14).		
3.	The board discussed with the independent auditor any disagreements with management, consultation with other independent accountants, difficulties encountered in performing the audit, major issues discussed with management prior to retention, significant deficiencies in internal control, fraud, and illegal activity.		
4.	Reviewed the management representation letter.		
5.	Reviewed the performance of external auditor, including the lead audit partner.		

with other small organizations to perform internal audit functions for each other.

Management, the board, and the audit committee should review and make recommendations for an internal audit's annual audit plan and any significant changes made to that plan. They should evaluate the performance of the internal audit function on a periodic basis.

The board and audit committee should review the internal audit's summary of audits completed and the management's response to the audits. They should also review any difficulties encountered by an internal audit and any limitations on the audit scope or access to information. They should meet with the senior internal auditor independently from management and the independent auditor. If open meeting laws prohibit these meetings to be held in executive session, the board chair or audit committee chair should meet independently with the internal auditor and report back to the board or audit committee on unresolved problems.

Action

Exhibit 7 presents an internal audit checklist. Management, the board, and the audit committee should use this checklist to assess the objectivity and performance of the independent auditor. Management and the board should require corrective action where deficiencies exist.

Management Oversight

Management, the board, and the audit committee should review and recommend improvements to the governance, risk, or financial internal controls policies and practices. They should evaluate the control environment as defined by COSO's Internal Control—Integrated Framework.

Management, the board, and the audit committee should review the policies and practices relating to the organization's compliance and ethics program. The board should also review the policies and practices related to the employee code of conduct, the code of conduct for senior financial officers, and the code of conduct for contractors.

Management, the board, and audit committee should review and recommend policies and practices for the receipt, retention, and treatment of complaints received by the organization regarding accounting, internal controls, or auditing matters. They also should review and recommend policies and practices for the confidential anonymous submissions by

Exhibit 7: Checklist for Oversight of Internal Audit

Organization Name: ______________________________

Completed by: ______________________ Date: __________

The board and audit committee:

		Yes	No
1.	The board or board chair held discussions in separate meetings with the internal auditor, management, and the independent auditor.		
2.	Reviewed any difficulties encountered by the internal audit and any limitations on the audit scope or access to information.		
3.	Reviewed the internal audit charter.		
4.	Discussed internal audit's compliance with the Institute of Internal Auditors' Standards for the Professional Practice of Internal Auditing.		
5.	Evaluated the internal audit's performance.		
6.	Reviewed and made recommendations for the internal audit's annual audit plan and significant changes to the plan.		
7.	Reviewed the internal audit's budget, staffing, and qualifications.		
8.	Reviewed the internal audit's summary of audits completed and the administration's response.		
9.	Reviewed the appointment, compensation, and change of the senior internal auditor.		

employees or suppliers of concerns with regard to auditing, accounting, or internal control matters. It should review significant complaints regarding accounting, internal control, or auditing matters.

Action
Exhibit 8 provides a checklist for assessing management oversight. Management, the board, and the audit committee should use this checklist to assess the objectivity and financial performance of management. Management and the board should require corrective action where deficiencies exist.

Audit Committee

Management and boards may form audit committees to monitor the organization's financial reporting, internal control, internal audit, and external audit processes and to advise management and the board on auditing, internal control, and financial reporting issues.

Audit committees provide organizations with the following advantages. The audit committee:

- Evaluates auditor findings and recommends policy, regulation, or process solutions to the management and board for internal control or financial reporting issues. The audit committee recommendations allow the focus to be on the proposed policy, regulation, or process solutions rather than on the problem.
- Recommends policies, regulations, or processes that make it easy for organization employees, board members, volunteers, students, and contractors to be honest.
- Monitors both internal and external auditors.
- Reviews audit plans with the auditors and recommends improvements to the plans.
- Monitors financial statements and related disclosures.
- Improves, through its process, public accountability for financial resources.
- Brings additional financial expertise to the audit and financial oversight process.
- Improves public confidence in the information the public receives to assess the acquisition and use of public resources, the sufficiency of current resources to meet current costs, and the

Exhibit 8: Checklist for Oversight of Management

Organization Name: ____________________
Completed by: ____________________ Date: __________

The board and audit committee:

		Yes	No
1.	The board or board chair held discussions in separate meetings with the management, the independent auditor, and the internal auditor.		
2.	Reviewed the qualifications of the chief financial officer, the controller, and the accounting staff.		
3.	Reviewed governance and financial internal control policies and procedures and the cost/benefit of these policies and procedures. Reviewed financial governance monitoring reports.		
4.	Reviewed the performance of management's financial functions.		
5.	Reviewed the control environment.		
6.	Reviewed policies and practices relating to the codes of conduct.		
7.	Reviewed policies and practices relating to the compliance and ethics program.		
8.	Reviewed and recommended policies and practices for the receipt, retention, and treatment of complaints received by the organization regarding accounting, internal controls, or auditing matters.		
9.	Reviewed and recommended policies and practices for the confidential, anonymous submissions by employees of concerns with regard to auditing, accounting, or internal control matters.		
10.	Reviewed significant complaints regarding accounting, internal controls, or auditing matters.		

change from previous years in the organization's ability to provide services.

The audit committee charter states the duties, responsibilities, and limitations of the audit committee. The charter describes the purpose of the committee, which may include some of the advantages listed in the previous paragraph.

The charter describes requirements for committee membership. Audit committee members or their immediate family should not be employees or contractors of the organization. Committee members or their immediate family should have no conflicts of interest with the organization. Committee members should be able to understand fundamental financial statements as well as financial statement, internal control, compliance, and operational auditing processes. At least one of the committee members should be a financial expert who possesses the experience and skills necessary to understand complex and technical financial reporting issues.

The charter describes how often the committee meets. It also states that committee meetings are governed by organization policy and the laws of the state. In many states, all meetings should be open to the public and proper notice should be given for the meetings.

The audit committee should report its activities and recommendations to the board on a regular basis. The committee should maintain open and free communications with the board, management, internal auditors, and the independent auditor. The committee should have access to the organization's personnel, records, and facilities.

New committee members should receive an appropriate orientation briefing. The organization should provide committee members with educational resources related to current accounting topics, principles, and procedures.

The audit committee is a recommending body to management, the board, and the auditors. The committee should have no policy-making authority and no administrative authority. The committee should not evaluate the performance of any individual employee of the organization. Any recommendations it makes should not substitute for any required

Best Practices: Audit Committee

Audit Committee Bylaws and Calendar—Clark County School District, Nevada
The Clark County School District is the fifth-largest school district in the country. The audit committee bylaws and calendar provide detailed guidance for audit committee operations. It includes many of the best practices recommended in this document. The calendar, which is patterned after the Microsoft Corporation's audit committee calendar, provides the audit committee chair detailed guidance for preparing the agenda for the audit committee's quarterly meetings.

Source: *www.boarddocs.com/nv/ccsdlv/Board.nsf/7f0976c2db2919ff8725732800681a69/2ebdb31cedf243ec872575b3007977c8/$FILE/062509%20Ref.%206.01.pdf*

Audit Committee Charter Guidance—State of New York
The State of New York requires all public school districts with eight teachers or more to establish an audit committee to assist and advise the board on audit functions. This document provides guidance to organizations on developing an audit committee charter. It includes an audit committee charter template.

Source: *www.osc.state.ny.us/localgov/sfa/accharter.pdf*

Audit Committee Charter Resolution—Cincinnati Public Schools, Ohio
The Cincinnati Board of Education adopted an audit committee charter with this resolution. The resolution references the corporate governance, auditor independence, and internal control assessment issues addressed by the Sarbanes-Oxley Act of 2002. It also notes that an Audit Committee Charter is considered best practice by the American Institute of Certified Public Accountants (AICPA), Government Finance Officers Association (GFOA), Association of Business Officials (ASBO) as well as other professional and organizations.

Source: *www.cps-k12.org/general/finances/AuditResSept08.pdf*

Audit Committee Charter—Pinal County, Arizona
This audit committee charter states the purpose, authority, responsibilities, committee composition and terms, and member qualifications for the audit committee.

Source: *http://pinalcountyaz.gov/Departments/InternalAudit/Documents/PINAL%20CO%20AUDIT%20COMMITEE%20CHARTER-NOV2008.pdf* review and acceptance by the board. The annual audit report prepared by the independent auditor should not be deemed final until accepted by a resolution of the board.

The audit committee should not consider the character, alleged misconduct, or professional conduct of a person. Any such issues should be directly referred to the chief operating officer, who shall inform the board. Issues involving the character, alleged misconduct, or professional conduct of the chief operating officer should be directly referred to the president of the board.

The organization's management is responsible for ensuring that the financial statements are in accordance with generally accepted accounting principles and are complete and accurate. Management is also responsible for establishing satisfactory internal controls over financial reporting and for compliance with laws, regulations, and policies. The independent auditor is responsible for auditing the financial statements and the internal controls over financial reporting. It is neither the responsibility nor duty of the audit committee or the board to plan or conduct audits, to determine that the financial statements are complete, accurate and in accordance with generally accepted accounting principles, or to assure compliance with laws, regulations, and policies.

Many audit committee responsibilities can be defined in an audit committee responsibilities calendar. The charter recommends the quarter when specific actions should take place. Some actions might be done on an as-required basis. In addition to the audit committee information stated in this section, the audit committee charter should contain the same actions described in the preceding exhibit checklists for Financial Reporting, Internal Control, and Compliance; Independent Auditor; Internal Audit; and Management matters.

Action
Management and the board should establish an audit committee to assist them with their oversight duties. Appendix II provides an example of a charter for an audit committee. Management and the board should require corrective action where deficiencies exist.

Appendix I: Risk Management Template

This appendix illustrates an example of a partially completed risk management template.

The organization begins completing the risk management template by listing opportunity and threat outcome events in column 2 of the template. In column 3, the organization lists a brief description of the impact of the outcome. In column 4, the organization rates the outcome impact as high or low. The information to complete these steps comes from the identification analysis done in Step 1, including the outcomes identified in Table A.1. The organization should give each outcome event listed in column 2 a reference in column 1 to keep the analysis organized. The organization may want to use O for opportunities and T for threats in its referencing system, or it can keep the opportunity and threat outcomes separate.

In the Current Control column, state what controls, if any, are currently in place to achieve opportunity outcomes and to prevent threat outcomes. In the Likelihood column, assess the likelihood of the event occurring as high or low based on the controls currently in place. This assessment comes from Step 2.

In the Control Actions column, the organization should state the new control actions it intends to implement for each outcome event. Steps 3, 4, and 5 describe some control actions the organization may want to consider implementing. The organization should then reassess the likelihood of the event occurring assuming that it adequately implements the proposed control actions and put this assessment in the second Likelihood column. The organization should assign a deadline and leader for each control action in the Deadline and Leader columns, respectively.

Table A.I: Risk Management Template

Ref.	Outcome Event	Outcome Impact	Impact (L,H)	Current Controls	Likelihood (L,H)	Control Actions	Likelihood (L,H)	Deadline	Leader
O1	High graduation rates.	Individual student and society benefit. Positive media coverage and enhanced organization reputation.	H	Identification of students who dropped out.	L	Intervention for students at high risk for dropping out or who recently dropped out.	H	May 2010	Supt.
O2	Excellent reading test scores.	Individual student and society benefit. Positive media coverage and enhanced organization reputation.	H	Identification of students needing remedial help with reading.	L	Required remediation for students who do not meet minimum reading standards.	H	May 2011	Supt.
T1	Sexual harassment of employee.	Damage to employee. Negative media coverage and reputational damage. Litigation losses.	H	No prevention training provided. No code of conduct for employees.	H	Sexual harassment prevention training provided. Employee code of conduct signed by all employees.	L	Sept. 2010	Supt.
T2	Employee theft of assets.	Negative media coverage and reputational damage. Financial loss.	H	Poor segregation of duties. No code of conduct for employees. No internal auditor.	H	Signed employee code of conduct. Training provided. Internal audit function established.	L	Sept. 2010	Supt.

Appendix II: Audit Committee Charter

Role

The _________________ Organization (Organization) Board of Trustees (Board) formed the Audit Committee (Committee) to advise the Board in the following areas:

- Monitoring the Organization's financial reporting, internal control, internal and external audit processes, and compliance with laws, regulations, and ethics policies;
- Advising the Board of auditing, internal control, compliance, and financial reporting issues;
- Recommending policies, regulations, or processes to the Board to make it easy for organization employees, organization contractors, and students to be honest; and
- Performing other duties as directed by the Board.

Membership

The membership of the Committee shall consist of the Vice President and Clerk of the Board and one to three non-Board members. The non-Board members shall serve without compensation. The Board appoints Committee members and the Committee chairperson to renewable, staggered two-year terms. The Board may remove Committee members at any time with or without cause. Each Board member shall, in the judgment of the Board, meet the following criteria:

- **Independence:** Committee members or their immediate family shall not be employees of the organization nor of contractors of the organization.

  Committee members or their immediate family members shall have no conflicts of interest with the organization.
- **Financial Literacy:** Committee members shall be able to understand fundamental financial statements and the financial statement, internal control, compliance, and operational auditing processes.
- **Financial Expertise:** At least one of the Committee members shall be a financial expert who possesses the experience and skills necessary to understand complex and technical financial reporting issues.

Committee members shall be reimbursed for any actual and necessary expenditures incurred in relation to attendance at meetings.

Operations

The Committee shall meet at least four times per year. Additional meetings may be scheduled by the Committee chairperson or the Committee. In the absence of the Committee chairperson, a majority of the Committee members present may appoint a Committee member to preside at the meeting.

Committee meetings are governed by Organization policy and the laws of the State of _________. Proper notice shall be given of all Committee meetings. All meetings shall be open and public, except as otherwise provided by specific statute. During each Committee meeting, public comment will be taken. The Committee shall consult with the Board's legal counsel prior to utilizing executive session privileges.

Communications

The Committee shall report its activities and recommendations to the Board on a regular basis. The

Committee shall maintain open and free communications with the Board, management, internal auditors, and the independent auditor. The Committee shall have access to the Organization's personnel, records, and facilities.

Education

New Committee members shall receive an appropriate orientation briefing. The Organization shall provide Committee members with educational resources related to current Organization accounting topics, principles, and procedures.

Responsibilities

The Audit Committee Responsibilities Calendar defines the Committee's specific responsibilities.

Limitations of Committee Authority and Responsibilities

The Committee is a recommending body to the Board, management, and auditors. The Committee has no policy-making authority and no administrative authority. Any recommendations it makes shall not substitute for any required review and acceptance by the Board. The annual audit report prepared by the independent auditor shall not be deemed final until accepted by a resolution of the Board.

The Committee shall not consider the character, alleged misconduct, or professional conduct of a person. Any such issues shall be directly referred to the chief operating officer, who shall inform the Board. Issues involving the character, alleged misconduct, or professional conduct of the chief operating officer shall be directly referred to the President of the Board.

The Organization's management is responsible for ensuring that the financial statements are in accordance with generally accepted accounting principles and are complete and accurate. The Organization's management is also responsible for establishing satisfactory internal controls over financial reporting and for compliance with laws, regulations, and policies. The independent auditor is responsible for auditing the financial statements and the internal controls over financial reporting. It is not the responsibility or duty of the Committee or the Board to plan or conduct audits; to determine that the financial statements are complete, accurate and in accordance with generally accepted accounting principles; or to assure compliance with laws, regulations, and policies.

References

Abraham, J. (2007). *Vitiating Vulnerability.* Trusteeship. (Sep-Oct 2007).

Auditing Standards Board. (2002). *Statement on Auditing Standards No. 99, Consideration of Fraud in a Financial Statement Audit.* New York: American Institute of Certified Public Accountants.

Auditing Standards Board. (2006). *Statement on Auditing Standards No. 114, The Auditor's Communication With Those Charged With Governance.* New York: American Institute of Certified Public Accountants.

Bailey, J. (2007). *A Symbiotic Relationship.* Internal Auditor. (April 2007).

Bailey, J. (2007). *Best Practices for Internal Auditor Independence*. Internal Auditing (March/April 2007).

Biegelman, M. (2008). *Building a World Class Compliance Program: Best Practices and Strategies for Success.* New Jersey: John Wiley & Sons, Inc.

Brancato, C., and C. Plath. (2003). *Corporate Governance Best Practices: A Blueprint for the Post-Enron Era.* New York: The Conference Board.

Burke, F., D. Guy, and K. Tatum. (2004). *Audit Committees: A Guide for Directors, Management, and Consultants.* New York: Aspen Publishers.

Business Roundtable. (2002). *Principles of Corporate Governance*. New York Stock Exchange Corporate Accountability and Listing Standards Committee Report.

Committee of Sponsoring Organizations of the Treadway Commission. (1992). *Internal Control—Integrated Framework*. (September 1992).

Committee of Sponsoring Organizations of the Treadway Commission. (2004). *Enterprise Risk Management—Integrated Framework*. (September 2004).

Court of Chancery of Delaware—Newcastle County. (1996). 698 A.2d 959 (September 25, 1996).

Dunklee, D. and R. Shoop. (1993). *A Primer for Risk Management: Creating and Maintaining Organization and Site-Based Liability Prevention Programs.* Needham Heights: Allyn and Bacon.

Gaustad, J. (1993). *Risk Management: How School Districts Can Identify Risks, Reduce Losses, and Conserve Funds.* OSSC Bulletin. (September 1993).

Hardy, K. (2010, 2nd. ed.). *Managing Risk in Government: An Introduction to Enterprise Risk Management.* IBM Center for The Business of Government.

Institute of Internal Auditors. (2008). *The Audit Committee: Internal Audit Oversight*. (October 2008).

Institute of Internal Auditors. (2009). *Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors*. Available at www.theiia.org/guidance/standards-and-guidance/ippf/standards/

National Association of Corporate Directors Blue Ribbon Commission. (2004). *Audit Committees: A Practical Guide*. Washington D.C.: National Association of Corporate Directors (NACD).

New York Stock Exchange. (2003). *Final New York Stock Exchange Corporate Governance Rules*. New York: New York Stock Exchange.

Public Company Accounting Oversight Board. (2007). *Auditing Standard No. 5: An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*. Washington D.C.: Public Company Accounting Oversight Board.

Public Company Accounting Oversight Board Staff Views. (2009). *Auditing Standard No.5: An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements: Guidance for Auditors of Smaller Public Company*. Washington D.C.: Public Company Accounting Oversight Board.

Rayner, Jenny (2003) *Managing Reputational Risk-Leveraging Opportunities Curbing Threats*. New Jersey: John Wiley and Sons Ltd.

Sarbanes-Oxley Act of 2002. U.S. Code. Vol. 15. sec. 7201 (2002). Washington D.C.: U.S. Government Printing Office.

Securities and Exchange Commission. (2001). *Seaboard Criteria: Release No. 44969*. Available at www.sec.gov/litigation/investreport/34-44969.htm

United States Sentencing Committee. (2009) *2009 Federal Sentencing Guidelines Manual Chapter 8-Part B: Effective Compliance and Ethics Program*. (November 2009).

U.S. Government Accountability Office. (2007). *Government Auditing Standards (The Yellow Book)*.

Acknowledgments

The author would like to express gratitude to the IBM Center for The Business of Government for supporting this work. Many people contributed valuable time and feedback to ensure successful completion of this report—specifically, Jonathan D. Breul, Mark Abramson, and the IBM Center staff.

ABOUT THE AUTHOR

Dr. James A. Bailey is a Professor of Accounting at Utah Valley University. He is a Certified Public Accountant, Certified Fraud Examiner, and Certified Internal Auditor. He teaches, researches, and consults in the areas of enterprise risk management, financial oversight, auditing, accounting, and fraud prevention.

Dr. Bailey led the business school at Truman State University and the department of accounting at Central Washington University. He also led the development of a new business school at the University of Southern Nevada. He has extensive public accounting experience, specializing in the audit of public companies.

His research has been published in *Internal Auditing*, *Internal Auditor*, *The CPA Journal*, *Issues in Accounting Education*, and *Management Accounting*. He is a member of the American Institute of Certified Public Accountants, the Association of Certified Fraud Examiners, and the Institute of Internal Auditors.

Dr. Bailey earned his Ph.D. in business with emphases in accounting, strategic management, and educational administration from the University of Nebraska-Lincoln, and his Master of Business Administration from the University of Utah.

KEY CONTACT INFORMATION

To contact the author:

Jim Bailey
Professor of Accounting
Utah Valley University – MS 103
800 West University Parkway
Orem, UT 84058
(801) 709-3313

e-mail: jabailey08@hotmail.com

REPORTS from
The IBM Center for The Business of Government

For a full listing of IBM Center publications, visit the Center's website at *www.businessofgovernment.org*.

Recent reports available on the website include:

Analytics

Strategic Use of Analytics in Government by Thomas H. Davenport

Collaboration: Networks and Partnerships

*Designing and Managing Cross-Sector Collaboration: A Case Study in Reducing Traffic Congestion*s by John M. Bryson, Barbara C. Crosby, Melissa M. Stone, and Emily O. Saunoi-Sandgren

Contracting

The Challenge of Contracting for Large Complex Projects by Trevor L. Brown, Matthew Potoski, and David M. Van Slyke

Defense

Transformation of the Department of Defense's Business Systems by Jacques S. Gansler and William Lucyshyn

E-Government/Technology

Using Geographic Information Systems to Increase Citizen Engagement by Sukumar Ganapati

Moving to the Cloud: An Introduction to Cloud Computing in Government by David C. Wyld

Financial Management

Managing Risk in Government: An Introduction to Enterprise Risk Management (2nd Edition) by Karen Hardy

Managing a $700 Billion Bailout: Lessons from the Home Owners' Loan Corporation and the Resolution Trust Corporation by Mark K. Cassell and Susan M. Hoffmann

Healthcare

The Role and Use of Wireless Technology in the Management and Monitoring of Chronic Diseases by Elie Geisler and Nilmini Wickramasinghe

Creating Telemedicine-Based Medical Networks for Rural and Frontier Areas by Leonard R. Graziplene

Human Capital Management

Federated Human Resource Management in the Federal Government by James R. Thompson and Rob Seidner

Managing for Performance and Results

Performance Reporting: Insights from International Practice by Richard Boyle

Strategic Risk Management in Government: A Look at Homeland Security by David H. Schanzer, Joe Eyerman, and Veronique de Rugy

Organizational Transformation

Transforming State Government Services Through Process Improvement: A Case Study of Louisiana by Vicki C. Grant

Social Services

US and UK Routes to Employment: Strategies to Improve Integrated Service Delivery to People with Disabilities by Heike Boeltzig, Doria Pilling, Jaimie C. Timmons, and Robyn Johnson

About the IBM Center for The Business of Government

The IBM Center for The Business of Government connects public management research with practice. Since 1998, we have helped public sector executives improve the effectiveness of government with practical ideas and original thinking. We sponsor independent research by top minds in academe and the nonprofit sector, and we create opportunities for dialogue on a broad range of public management topics.

The Center is one of the ways that IBM seeks to advance knowledge on how to improve public sector effectiveness. The IBM Center focuses on the future of the operation and management of the public sector.

About IBM Global Business Services

With consultants and professional staff in more than 160 countries globally, IBM Global Business Services is the world's largest consulting services organization. IBM Global Business Services provides clients with business process and industry expertise, a deep understanding of technology solutions that address specific industry issues, and the ability to design, build and run those solutions in a way that delivers bottom-line business value. For more information visit www.ibm.com.

For additional information, contact:
Jonathan D. Breul
Executive Director
IBM Center for The Business of Government
1301 K Street, NW
Fourth Floor, West Tower
Washington, DC 20005
(202) 515-4504, fax: (202) 515-4375

e-mail: businessofgovernment@us.ibm.com
website: www.businessofgovernment.org