**MEMORANDUM**

**DATE : July 12, 2016**

**TO:** **All CPA Firms**

**FROM:** **Jerry E. Durham, CPA, CGFM, CFE**

**Assistant Director, Division of Local Government Audit**

**SUBJECT: *Tennessee Code Annotated*, 9-18-102(a); Required Internal Control Policies and Procedures**

Our office has received several questions about the internal control policies and procedures required by *Tennessee Code Annotated*, Section 9-18-102(a). I am writing this memo to clarify the Division of Local Government Audit’s (LGA) position relative to the new state statute:

1. Governments are not required to submit their internal control policies and procedures to LGA or any other state agency.
2. Auditors are not responsible for auditing the local government’s internal control policies and procedures. Auditors have no more responsibility for risk assessment and testing internal controls now than before the new state statute was passed.
3. A system of internal control is required for the year ended June 30, 2016. The system of internal control must be documented in writing.
4. LGA has established an Internal Control and Compliance Manual based on the GAO Green Book. As indicated in the Preface to the manual, the principles and examples are not mandatory with **one exception** (See number 5 below).
5. **Every system of internal control must include the five components of internal control: a) Control Environment; b) Risk Assessment; c) Control Activities; d) Information and Communication; and e) Monitoring. Each of these components is described in LGA’s Internal Control and Compliance Manual.**

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1. Some officials may be familiar with the internal control checklists that have been prepared by LGA. These checklists can be used and adapted for a number of situations that involve segregation of duties. Segregation of duties falls under the “Control Activities” component of internal control. Utilizing the checklists does not establish a system of internal control because the checklists do not address all five components of internal control listed above.
2. Auditors are still only required to look at key controls over financial records and reporting as it relates to risk assessment procedures. Auditors are not looking to determine whether every type of control that might be possible has been implemented.
3. Auditors should ask whether or not each government has developed and documented a system of internal control as required by state statute and OMB’s new Uniform Guidance. LGA believes, if local governments have not made a good faith effort to document and implement a system of internal control, this should be at least a management finding. If internal controls are very poor, the finding might be elevated to a significant deficiency or material weakness. LGA intends to be somewhat lenient this first year.
4. Those charged with governance (TCWG; e.g. City Council) do not have to approve the internal control policies and procedures. LGA believes it is preferable for TCWG to play a role in emphasizing the importance of internal controls and indicating their desire that each department establish a system of internal control, perhaps by resolution. In other words, to set the “tone at the top.” LGA does not believe TCWG should write the policies and procedures. We believe this is the responsibility of management. However, each government has total discretion in this matter.
5. LGA believes that local governments receiving federal financial assistance (e.g. grants) have more responsibilities for internal controls under OMB’s new Uniform Guidance than before. For example, more controls over procurement and monitoring subrecipients. LGA believes that auditors should be prepared to write more compliance and internal control findings under the new Uniform Guidance.