

Audit Manual – January 2014 Update

Effective: Immediately

The following pages replace current guidance found on pages A-7 through A-9 of the Tennessee *Audit Manual* (dated June 30, 2013). These updates and clarifications are related to the auditor's consideration of fraud and illegal acts, Comptroller referrals, and cash shortages and thefts.

Until the 2014 *Audit Manual* is released, the following interim guidance will apply.

Consideration of Fraud and Illegal Acts

The auditor is responsible for performing risk assessment procedures and developing an audit plan for each audit. No one audit plan will suffice for every audit and no group of audit steps is comprehensive enough to cover all circumstances.

Comptroller Referrals

The Comptroller's office receives notifications from local governments, independent certified public accounting firms, private citizens, and other concerned parties regarding potential fraud, waste, and abuse of public funds. Local governments are required to report unlawful conduct to the Comptroller's Office in compliance with the Local Government Instances of Fraud Reporting Act and certified public accountants are contractually required to report all such matters to the Comptroller's Office.

Certain notifications received by the Comptroller's Office are referred to the contract auditor for consideration as part of their annual audit. The audit firm will receive a letter from our office summarizing the nature of the concerns addressed in the notification as well as the firm's responsibilities regarding the referral.

Cash Shortages and Thefts

Reporting Cash Shortages and Thefts

The reporting grid below illustrates the reporting requirements of the Comptroller's office as compared to *Government Auditing Standards* when reporting cash shortages and thefts. Please note that while the Yellow Book provides latitude in reporting instances of fraud that do not warrant the attention of those charged with governance, in light of public accountability for entities that are funded wholly or in part with public dollars, the Comptroller's office requires that all instances of fraud, regardless of materiality, be communicated to those charged with governance in the report on internal control over financial reporting and on compliance. In addition, all instances of fraud should be included in a schedule of cash shortages and thefts (described below).

Instances of Fraud (Includes Cash Shortages and Thefts)	GAGAS Requirement	Supplemental Comptroller Requirements
Instances of fraud that have a material effect on the audit (financial statements or other financial data significant to the audit objectives). (GAS 4.23, 4.25)	Communicate in the report on internal control over financial reporting and compliance. (GAS 4.23)	Also address all such matters in a schedule of cash shortages and thefts – current and prior years.

<p>Any other instances of fraud that warrant the attention of those charged with governance. (GAS 4.23)</p>	<p>Communicate in the report on internal control over financial reporting and compliance. (GAS 4.23)</p>	<p>Also address all such matters in a schedule of cash shortages and thefts – current and prior years.</p>
<p>Instances of fraud that do not warrant the attention of those charged with governance. (GAS 4.26)</p>	<p>Auditor’s determination of whether and how to communicate such instances to entity officials is a matter of professional judgment. (GAS 4.26)</p>	<p>Address all such matters, regardless of materiality or significance, in</p> <p>(1) the report on internal control over financial reporting and compliance as an other matter(s); and</p> <p>(2) a schedule of cash shortages and thefts – current and prior years.</p>

Schedule of Cash Shortages and Thefts – Current and Prior Years

All instances of cash shortages and thefts, even those deemed to be immaterial, should be reported. The schedule should encompass all fraudulent matters identified during the audit. For example, issues discovered during normal audit procedures, issues addressed in investigative reports issued by the Comptroller or state or federal agency, and issues developed internally by the auditee or internal audit staff should be reported. Other sources may include reports by local law enforcement agencies or other organizations that the CPA becomes aware of during the normal course of his audit.

The information in this schedule will be included in an annual report published by the Division of Local Government Audit and made available to the public on our website.

Contents of Schedule

The schedule should include the information and follow the format presented in the example schedule below. The schedule shall include the status of **all** current and prior year cash shortages, thefts and fraud, regardless of materiality.

All shortages, regardless of when they were initially reported, shall be tracked on the schedule until complete restitution has been collected or the governing body has taken and documented an official final action (write-off, insurance collection, etc.). Normally, write-offs would require action by those charged with governance.

The *explanations of cash shortages* section should detail the following information:

- A number that corresponds to the line item in the schedule;
- The fiscal year the cash shortage/theft was first reported in the audit report;
- The amount of the shortage/theft;

- The department (as applicable);
- A brief discussion of the nature of the shortage/theft;
- Reference to the separate regulatory investigative report, as applicable; and
- The final resolution (e.g. restitution, insurance recovery, amounts written-off by the governing body, indictments, etc.).

Filing of Schedule

This schedule will not be a part of the audit report, but should be submitted by the independent auditor in a pdf format through our online Contract and Report System (CARS) at the same time the audited financial statements are submitted.

Reporting Findings from Regulatory Investigative Reports and Other Sources

Released Reports

If the Comptroller's office or a state or federal regulatory body has publicly released a fraud investigative report during the contracted audit period or during the auditor's fieldwork for that audit, regardless of the period covered in the report:

- The report must be considered when conducting the audit and when reporting on internal control and compliance. Auditing standards require that investigative reports and other evidences of internal control weaknesses, cash shortages, and thefts be considered in developing the current audit strategy.
- Cash shortages and thefts identified in a regulatory investigative report should be reported in accordance with the supplemental Comptroller requirements as outlined in the reporting grid above.
- Relevant matters from the fraud investigative report should be addressed in the annual financial report and referenced to the investigative report, i.e., in the notes to the financial statements, the internal control and compliance report(s) and/or the management letter or letter to those charged with governance, as appropriate under current auditing standards. Those matters that are derived from a regulatory investigation and reiterated in the auditor's report on internal control and compliance should reference the fraud investigative report. Please note that auditing standards require the auditor to obtain and document sufficient audit evidence in the working papers to support the reiterated findings based on the auditor's work and not solely based on the work of other auditors. Audit evidence can be obtained in a variety of ways including, but not limited to, inquiry, results of transaction testing, etc.
- Findings developed from internal investigations, reports by law enforcement agencies, or reports of other organizations should be considered and reported in a manner similar to regulatory investigative reports.

On-going Investigations

In situations where there is an on-going fraud investigation, the auditor should follow the standards for determining the reporting and disclosure requirements in the annual financial report and auditor's reports. If the release of the annual financial report will be delayed due to an on-going fraud investigation, the auditor should contact the Division of Local Government Audit.

Town in Tennessee
Example Schedule of Cash Shortages and Thefts – Current and Prior Years
For the Period July 1, 2012 through June 30, 2013

	Fiscal Year First Reported	Department (This column may not always be applicable depending upon the type of local government.)	Original Audit Finding Number/Reference	Original Amount of Shortage	Beginning/Carry-Forward Balance	Current Year Shortage	Current Year Reductions (Collections and other Decreases)	End of Year Balance
1	2013	General Government	2013-02	\$14,500	-0-	\$14,500	-0-	\$14,500
2	2013	Highway and Streets	2013-07	\$200	-0-	\$200	\$200	-0-
3	2011	Board of Education	2011-05	\$15,000	\$14,000		\$1,000	\$13,000
4	2009	Water and Sewer	2009-12	\$500	\$500		\$500	-0-
5	2007	Police Department	2007-02	\$10,000	\$10,000		\$10,000	-0-

Explanations of Cash Shortages

1. General Government

The audit for the 2012-13 year reported a cash shortage of \$14,500. An investigative report issued by the Tennessee Comptroller of the Treasury in February of 2013 revealed that from May 2012 through October 2012, the bookkeeper fraudulently issued checks totaling \$14,500 for personal use. In July of 2013 the bookkeeper was found guilty of theft of \$10,000 or more, sentenced, and ordered to pay restitution totaling \$14,500 to the municipality. At June 30, 2013 no restitution payments had been made.

2. Highways and Streets

The audit for the 2012-13 year reported a cash shortage of \$200 in the street department. An employee claimed hotel and per diem meal reimbursements for an extra day of weekend travel that was not for an authorized municipal purpose. The employee was required to repay the amount to the municipality and was dismissed from employment.

3. Board of Education

The audit for the 2010-11 year reported a cash shortage of \$15,000 at the Board of Education. This shortage resulted from the misappropriation of petty cash funds by a municipal employee. The employee admitted to taking the petty cash funds and was subsequently terminated by the Board. The former employee is making annual restitution payments of \$1,000 until the amount is paid in full.

4. Water and Sewer Department

The audit for the 2008-09 year reported a theft of \$500 in the water and sewer department. The department's cell phone bills for January and February of 2009 reflected \$500 in charges for text messages for one employee. The employee confessed that the charges were for personal use and agreed to reimburse the town for the charges. The employee subsequently left employment with the town and did not repay the amount owed. An insurance payment related to the theft of \$500 was received during the current year.

5. Police Department

The audit for the 2006-07 year reported a theft of \$10,000 in the police department. A special investigation was conducted by the Tennessee Comptroller's office and is addressed in their report released in May of 2007. The theft was a result of confiscated drug funds being stolen by an employee of the department. The individual was terminated. The town does not intend to seek restitution and has recovered \$8,000 of the theft from insurance proceeds. The governing body has written-off the remaining \$2,000 as uncollectible. The theft has been reported to the local district attorney and is awaiting trial.