

## **EXECUTIVE ORDER NO. 85**

**EFFECTIVE DATE:** April 9, 2004

**SUBJECT:** INTERNAL CONTROL POLICY

### **PURPOSE**

*Internal control* is a process effected by management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: effectiveness and efficiency of operations; reliability of financial reporting; and compliance with applicable laws and regulations.

Internal control consists of five interrelated components: control environment; risk assessment, control activities, information and communication, and monitoring.

Internal controls protect Metro's assets against the danger of loss or misuse and are necessary to ensure that all transactions are properly authorized, and that the data contained in financial reports are reliable. This written policy establishes the overall control framework for Metro and compliance with this policy establishes the overall control environment at Metro.

### **RESPONSIBILITY**

Responsibility for maintenance and enforcement of internal controls is assigned as follows:

- The Chief Operating Officer will assure that Metro department staff is held accountable for compliance with approved policy and procedure and appropriate action is taken for non-compliance. The Chief Operating Officer shall assure that procedures developed within each Metro department conform to Metro's overall policy and procedure.
- Reporting to the Chief Operating Officer, Metro's Chief Financial Officer (CFO) and his/her staff (whose control activities cut across, as well as up and down, the operating units of Metro) is primarily responsible for oversight of internal control policy and procedure and Metro's compliance with those policies and procedures.
- Other Metro senior level staff, in turn, assign responsibility for establishment of more specific internal control policies and procedures to personnel responsible for that unit's functions. Such policies and procedures shall conform to Metro's overall policy and procedure guidance.

### **ESSENTIAL ELEMENTS**

Metro's internal control structure will encompass all three of the following elements:

**A. Control environment.** For accounting systems and control procedures to be effective, they must be viewed by employees as an essential and integral part of their job duties, in the process of providing services to citizens. Management must support and enforce the controls.

**B. Accounting system.** The accounting system must be properly designed and maintained to meet Metro's information needs, including the periodic preparation of both internal and external financial reports in accordance with generally accepted accounting principles (GAAP) and applicable laws.

**C. Control policies and procedures.** Specific control policies and procedures must be in place to ensure the integrity of the data in the accounting system and to ensure that assets are protected against loss and misuse.

**IMPLEMENTATION**

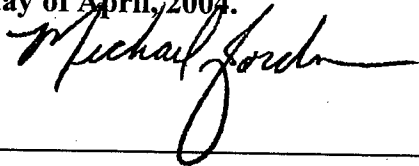
Metro shall implement the internal control policy by implementing three activities: policy and procedure manuals; on-going evaluation and annual assessment.

**A. Policy and Procedure Manuals.** Metro shall maintain written policy and procedure manuals that clearly outline the specific authority and responsibility of individual employees. This documentation will provide the basis for establishing employee accountability. Further, the manuals will serve as a reference tool for those employees who seek guidance on the proper handling of transactions and situations and will be used as a training tool to provide for consistency of procedures during periods of employee turnover.

**B. Evaluation of Internal Controls.** Management shall identify control cycles, perform vulnerability assessments, document controls, identify key controls and test those key controls. Metro management shall use their professional judgement in performing these tasks. Primary responsibility for these efforts is assigned to the staff of the Chief Financial Officer. In designing key controls, Metro management shall identify errors or irregularities that could occur in a given control cycle or accounting application and use the documentation of control procedures to determine what controls are in place to avoid such errors or irregularities.

**C. Annual Internal Control Assessment Report** The Chief Operating Officer shall prepare a written report after the close of each fiscal year that asserts the effectiveness of internal controls. The report shall be guided by the five components of internal control (control environment, risk assessment, control activities, information and communication, and monitoring). All significant deficiencies and material weaknesses shall be included in this report.

**ORDERED** by the Chief Operating Officer this 9<sup>th</sup> day of April, 2004.

A handwritten signature in cursive script, appearing to read "Michael Jordan", written over a horizontal line.

Michael Jordan  
Chief Operating Officer

# **Metro Internal Control Policy**

## **Metro's Overall Internal Control Framework**

### **I. Introduction**

Internal controls protect Metro's assets against the danger of loss or misuse. Internal controls are also necessary to ensure that all transactions are properly authorized, and that the data contained in financial reports are reliable.

Metro recognizes that there are additional costs associated with weak internal controls and potential fraud that include the loss of public confidence and trust, loss of reputation of the innocent and the punishment and cost of prosecuting the perpetrator of fraud.

To be effective, the best designed controls must have the *active* involvement and support of management. **Internal control** is defined broadly as a process effected by management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: effectiveness and efficiency of operations; reliability of financial reporting; and compliance with applicable laws and regulations. Internal control consists of five interrelated components: control environment; risk assessment, control activities, information and communication, and monitoring.

This written policy establishes the overall control framework for Metro and compliance with this policy establishes the overall control environment at Metro.

### **II. Responsibility**

Responsibility for maintenance and enforcement of internal controls is assigned as follows:

- The Metro Council is ultimately responsible and will assume ownership of the system.
- The Chief Operating Officer will assure that Metro department staff is held accountable for compliance with approved policy and procedure and appropriate action is taken for non-compliance. The Chief Operating Officer shall assure that procedures developed within each Metro department conform to Metro's overall policy and procedure.
- Reporting to the Chief Operating Officer, Metro's Chief Financial Officer (CFO) and his/her staff (whose control activities cut across, as well as up and down, the operating units of Metro) is primarily responsible for oversight of internal control policy and procedure and Metro's compliance with those policies and procedures.
- Other Metro senior level staff, in turn, assign responsibility for establishment of more specific internal control policies and procedures to personnel responsible for that unit's functions. Such policies and procedures shall conform to Metro's overall policy and procedure guidance.

### **III. Purpose of Internal Controls**

Metro financial managers are required to be good stewards of the resources committed to their care. Good stewardship requires that assets be properly safeguarded, managed and accounted for.

**A. *Safeguarding.*** Metro managers have a duty to protect Metro's assets against the danger of loss or misuse and to ensure that *all* transactions are properly authorized.

**B. *Management.*** Metro officials have a duty to establish policies to ensure the efficient and effective management of resources provided to the agency. They also have the duty to establish procedures to ensure that these policies and other management directives are *consistently followed* in practice. Procedures must also be established to ensure and document that Metro is complying with applicable legal requirements.

**C. *Accountability.*** Metro financial managers have a duty to report on their stewardship of public resources. As a result, they must establish accounting systems that provide data for inclusion in financial reports. For accountability purposes, all underlying data maintained in such systems must be reliable.

### **IV. Essential Elements of an Effective Internal Control Structure**

Metro's internal control structure will encompass all three of the following elements:

**A. *Control environment.*** For accounting systems and control procedures to be effective, they must be viewed by employees as an essential and integral part of their job duties, in the process of providing services to citizens. Management must support and enforce the controls.

**B. *Accounting system.*** The accounting system must be properly designed and maintained to meet Metro's information needs, including the periodic preparation of both internal and external financial reports in accordance with generally accepted accounting principles (GAAP) and applicable laws.

**C. *Control policies and procedures.*** Specific control policies and procedures must be in place to ensure the integrity of the data in the accounting system and to ensure that assets are protected against loss and misuse.

### **V. Control Environment**

Metro requires the following characteristics in its control environment:

- A.** Management is aware of the importance of internal controls and communicates this importance, in *word and actions*, to employees at all levels of the organization;
- B.** Metro will have a rational and well-defined organizational structure that *clearly* assigns responsibility and accountability to individual employees;
- C.** Metro will have sound personnel policies and practices in place;
- D.** Metro management will actively monitor operations and investigate discrepancies between actual performance and anticipated results; and

- E. Metro's governing body will oversee management on a continuing basis (for example, through coordination with the Office of the Metro Auditor and its audit committee).

Without the above environmental factors, the potential effectiveness of the accounting system and of control policies and procedures is greatly diminished.

**1. Management involvement.** Internal controls require an ongoing investment of time, effort and resources. For this reason, management involvement is essential for internal controls to function effectively. Internal controls, as a result of various pressures over time have a tendency to break down. Metro management will resist this natural breakdown by doing all of the following on a continuing basis:

*a. Set the tone.* Management will attach importance to internal controls so employees will do likewise; and

*b. Educate employees.* Management will ensure that employees at all levels of the organization understand the purpose and importance of the control procedures they are being asked to perform; and

*c. Provide resources.* Management will provide the resources necessary to ensure that the control structure is properly designed and maintained. This can be accomplished through periodic compliance testing and reviews, performed by both internal and external parties.

**2. Metro Council to Maintain Oversight of Management.** Only the Metro Council can ensure that management fulfills its obligation to establish and maintain an adequate internal control structure. In addition, because top management is in a position to override whatever controls it establishes, the Council must compensate for this potential control weakness by serving as the final level of accountability.

**3. Organizational structure.** For internal controls to be effective, individual employees will be assigned specific powers and responsibilities for which they will be held accountable. This assignment of authority will be clearly communicated and documented. Without such accountability and the presence of poor organizational structure, circumvention of controls is greatly facilitated.

**4. Sound Personnel Policies and Practices.** Metro will strive, through its personnel policies and practices documented elsewhere, to hire only qualified and honest individuals for sensitive positions in Metro's internal control structure. Metro will maintain well-designed job descriptions and require appropriate job qualifications to help ensure that employees are competent for their assigned tasks.

Management will ensure that employee's performance is periodically evaluated and documented, and appropriate corrective action is taken, as called for by the circumstances. Management should ensure that employee's skills remain current through continuing training and education.

**5. Management Actively Monitors Operations.** Management will monitor financial results for indications of potential problems. Such monitoring will assist in preventing irregularities from occurring, as employees will know that irregularities that may be an indicator of fraud will be actively sought out by management and rigorously investigated.

**6. Audit Committee.** The role of any Metro Audit Committee is to maintain management's accountability to the governing body. Many of the objectives of an audit committee have been assumed by the Office of Metro Auditor. The Office of Metro Auditor will provide oversight of management by issuing periodic reports to the Council on audit findings concerning internal controls.

## **VI. Accounting Systems**

Accounting systems include not only technological solutions, such as hardware and software, but also include all of the policies and procedures required to achieve the objectives and standards contained in this section. Metro staff shall comply with such policies and procedures to ensure the effectiveness of these systems. Metro shall implement accounting systems that meet the following core objectives:

- A. The system shall assemble information on all finance-related transactions and events;
- B. The system shall provide the ability to analyze all of the data collected and the effect of that data on Metro's assets and liabilities;
- C. The system shall classify data in accordance with Metro's chart of accounts;
- D. The system shall record data in appropriate books of accounts;
- E. The system shall report data to management and to outside parties – internal and external financial reporting, respectively, in an appropriate format and in a timely manner;
- F. The system shall maintain accountability for all of Metro's assets irrespective of the department or geographical location in which they reside.

Metro shall implement effective accounting systems that meet the following standards:

- G. All of the assets and liabilities recorded in the system actually exist, and all of the reported transactions and events really occurred;
- H. None of Metro's assets or liabilities has been omitted from the accounting system, nor has any relevant transaction or event been excluded;
- I. All of the assets and liabilities recorded in the system are, in fact, assets and liabilities of Metro;
- J. Estimates made for accounting and financial reporting purposes are supported by proscribed procedures and made in compliance with proscribed procedures of the Metro Code and Manual of Policies and Procedures. Examples of estimates include "bad debts" owed to Metro which must be identified and aged properly and written off when appropriate; post-closure care estimates for landfill closure; actuarial estimates for risk and pension liabilities.
- K. The effects of transactions and events are recorded in the appropriate accounting period;
- L. The accounting system collects all the data needed to present and disclose assets, liabilities, transactions and events as required under generally accepted accounting principles (GAAP) in accordance with standards issued by the Governmental Accounting Standards Board and the GAAP hierarchy.

## **VII. Control Policies and Procedures**

### **A. Evaluating Antifraud Processes and Controls**

Metro will be proactive in reducing fraud opportunities by (1) identifying and measuring fraud risks, (2) taking steps to mitigate identified risks, and (3) implementing and monitoring appropriate preventive and detective internal controls and other deterrent measures.

#### **1. Identifying and Measuring Fraud Risks**

Metro management has primary responsibility for establishing and monitoring all aspects of the agency's fraud risk-assessment process and prevention activities. This risk-assessment will consider the vulnerability of Metro to fraudulent activity (fraudulent financial reporting, misappropriation of assets, and corruption) and whether any of those exposures could result in a material misstatement of the financial statements or material loss to the agency.

#### **2. Mitigating Fraud Risks**

Metro will develop activities and processes that are designed to reduce or eliminate certain fraud risks when possible.

#### **3. Implementing and Monitoring Internal Controls**

Metro will identify the processes, controls and other procedures that are needed to mitigate identified risks, including a well-developed control environment, and effective and secure information system, and appropriate control and monitoring activities. Because management has the ability to override controls, or to influence others to perpetuate or conceal fraud, the need for a strong value system and a culture of ethical conduct and financial reporting is expected at Metro.

As an integral part of Metro's control environment and accounting systems, control policies and procedures shall be established and documented. Metro's control policies and procedures shall be adequate to ensure that:

- a) **All transactions are properly authorized.** Metro's written policies and procedures shall clearly state which individuals have the authority to authorize each different type of transaction. Such authorization shall be obtained in advance and in writing and the documentation shall be maintained for later review.
- b) **Incompatible duties are segregated.** No Metro employee should be in a position to both commit an irregularity and conceal it. No single individual should be able to *authorize* a transaction, *record* the transaction in the books of account and ensure *custody* of the asset. Where it is impractical to segregate duties (cost versus benefit considerations), other compensating controls must be established and documented.
- c) **Accounting records and documentation are properly designed and maintained.** Such design must include measures to ensure that Metro's accounting records are complete. Key documents should be sequentially numbered and accounted for and procedures shall be documented to account for void documents, legal retention requirements, computer system and data backup requirements.
- d) **Access to both assets and records is controlled.** Metro shall maintain physical security over its assets. Sensitive items must be kept in locked storage at all times when not in use.

Controls over access to records shall be maintained in a manner that hard copy records are accessible only to authorized employees. Specific individuals shall be assigned responsibility for the custody of specific records. Access to computers shall be restricted to authorized individuals and limited to that individual's specific information needs as it relates to their job assignment at Metro.

- e) **Accounting data are periodically compared with the underlying items they represent (reconciled).** Metro shall routinely reconcile all key accounts and perform annual inventories of assets to ensure that all recorded items are, in fact, in Metro's custody.

Metro management shall ensure that there is prompt follow up on all indications of potential errors or irregularities. Each such instance shall be resolved and documented, and corrective action taken as appropriate in the circumstances. Professional skepticism on the part of management shall be observed, resulting in documented explanations of discrepancies with corroboration of supporting evidence.

The cost of control policies and procedures should not outweigh the benefits to be achieved.

### **VIII. Policy and Procedure Manuals**

Metro shall maintain written policy and procedure manuals that clearly outline the specific authority and responsibility of individual employees. This documentation will provide the basis for establishing employee accountability. Further, the manuals will serve as a reference tool for those employees who seek guidance on the proper handling of transactions and situations and will be used as a training tool to provide for consistency of procedures during periods of employee turnover.

Metro shall provide resources to keep the policy and procedure manuals complete, up-to-date and available. In addition, the manuals shall have the support of high-level management and be formally approved by them.

### **IX. Evaluation of Internal Controls**

Metro management is responsible to evaluate the effectiveness of internal controls on an on-going basis. Management shall identify control cycles, perform vulnerability assessments, document controls, identify key controls and test those key controls. Metro management shall use their professional judgement in performing these tasks. Primary responsibility for these efforts is assigned to the staff of the Chief Financial Officer.

Documentation of internal controls may be accomplished using various methods. Whichever method is chosen must provide that the documentation (1) be in writing, (2) clearly disclose who is to perform each procedure and (3) how each procedure is to be documented.

In designing key controls, Metro management shall identify errors or irregularities that could occur in a given control cycle or accounting application and use the documentation of control procedures to determine what controls are in place to avoid such errors or irregularities. Metro management shall then assess whether the controls are properly designed. If properly designed, the controls should be tested to determine if the controls are functioning as designed in practice. If not properly designed, Metro management shall implement internal controls, including possible compensating controls, appropriate in the circumstances.

## **X. Annual Internal Control Assessment Report**

The Chief Operating Officer shall prepare a written report after the close of each fiscal year that asserts the effectiveness of internal controls. The report shall be guided by the five components of internal control (control environment, risk assessment, control activities, information and communication, and monitoring). All significant deficiencies and material weaknesses shall be included in this report. The documentation supporting this report shall encompass all significant account balances and disclosures, including controls over estimates made in the financial statements.

Sources:

*An Elected Official's Guide to Internal Controls*, Stephen J. Gauthier, Government Finance Officers Association, Chicago, Illinois, 1994.

*Internal Control – Integrated Framework*, Committee of Sponsoring Organizations of the Treadway Commission, 1994, American Institute of Certified Public Accountants, Jersey City, New Jersey.

*Sarbanes-Oxley Act of 2002*, Section 404

*Management Antifraud Programs and Controls*, Statement on Auditing Standards No. 99, 2002, American Institute of Certified Public Accountants.