

## **Appendix D: Compliance ACE Form**

### **Assessment of the Compliance Controls' Environment**

In assessing the compliance controls environment, the auditor should consider:

- Existence of a monitoring system for compliance with such areas as debt issuance, budgets, contracts, and grants and assistance;
- Management's attitudes towards compliance with laws and regulations;
- Legal actions brought against the government, and/or its elected and appointed officials; and
- Involvement of the governing authority and management in the control structure to assure compliance.

The following factors may influence that auditor's assessment of risk of significant non-compliance with laws and regulations:

- Elected officials and management should convey the message that integrity and ethical values with the organization cannot be compromised and employees must receive and understand that message.
- Management must specify the level of competence needed for particular jobs, and translate the desired levels of competence into requisite knowledge and skills.
- An active and effective governing board, or committees thereof, provides an important oversight function and, because of management's ability to override system controls, the board plays an important role in ensuring effective internal control.
- The philosophy and operating style of management normally have a pervasive effect on an entity.
- The organizational structure should be neither so simple that it cannot adequately monitor the entity's activities nor so complex that it inhibits the flow of necessary information.
- The assignment of responsibility, delegation of authority and establishment of related policies provide a basis for accountability and control, and set forth individuals' respective roles.
- Human resources policies are central to recruiting and retaining competent people to enable the entity's plans to be carried out so its goals can be achieved.

A form to document the auditor's consideration of the compliance controls' environment follows. However, independent public accountants may use other similar practice aids as long as they cover all of the same areas for assessing the government's compliance controls environment.

### Instructions for Using the ACE Form

- **IMPORTANT:** This 2006 OCS ACE now groups the points of focus previously repeated in each chapter into a “common” section in the first table following this page. The subsequent sections include only points of focus specific to that OCS chapter (e.g. Chapter 1 budgeting). Where audit staffs have already completed a 2004 OCS ACE, they may choose to update the 2004 OCS ACE in lieu of completing this version, *if they add the points of focus newly included in this version.*
- The new points of focus are underlined in this version.
- Illustrative points of focus are given for each area. The auditor should not answer 'Yes' or 'No' to the points of focus. Rather, the auditor should comment on each area, using the points of focus as further guidance where appropriate, basing comments on information available from prior years' audits, inquiries of individuals inside and outside the organization, knowledge of factors outside the government that affect its activities, observation of circumstances that are known or are understood to exist within the government, and, in some circumstances, inspection of documents.
- The areas for assessment and illustrative points of focus in the ACE are not equally relevant to all engagements, and the significance of any particular area or point of focus varies with the government. Thus, the auditor should judge the applicability and importance of each in the context of the engagement.
- In assessing the control environment, the auditor should recognize that neither the areas for assessment nor the illustrative points of focus are necessarily all-inclusive. The auditor may encounter matters affecting the control environment other than those addressed by the ACE. The auditor should document those matters and assess their effect on the control environment.
- In assessing the control environment, the auditor should look beyond the form of control measures and management actions and should concentrate on their substance. An environment may appear to be favorable but in reality may not be. For instance, a system may provide adequate reports for the governing board or senior management, but if the information is not analyzed and acted on, the system does not contribute to the control environment. Similarly, a government may establish appropriate policies; however, to be effective, they should be enforced by management. For example, although a government may have a formal code of conduct, management may have a record of condoning actions that violate it. By not reprimanding such actions, management sends a clear message undermining the code of conduct.

### Audit Implications

- After assessing each area, the auditor should consider the audit implications of any circumstances coming to his or her attention that may affect the audit strategy and audit program, or that may represent a matter for which we can offer a recommendation for improvement.

### Application to Small and Mid-sized Entities

- Small and mid-sized entities may implement the control environment areas differently than larger entities. For example, smaller entities might not have a written code of conduct but instead, develop a culture that emphasizes the importance of integrity and ethical behavior through oral communication and by management example. However, these conditions may not affect the auditor's assessment of control risk.

### Note to Auditor of State Employees

- If the compliance points of focus are adequately addressed in the financial ACE that you completed, a cross reference to that documentation is sufficient.

<b>General Compliance Environment Considerations Applicable to All OCS Chapters</b>	
<b>Area for Assessment</b>	<b>Comments</b>
<p>The following factors may influence the auditor's assessment of risk of significant non-compliance with laws and regulations:</p> <p><i>Elected officials and management should convey the message that integrity and ethical values with the organization cannot be compromised and employees must receive and understand that message.</i></p> <p><i>Similarly, elected officials and managements' actions should demonstrate a clear commitment to complying with applicable laws and regulations, and a policy of disciplining those who do not comply with applicable laws or those attempting to override prescribed controls.</i></p> <p><i>Elected official and management should demonstrate an interest in assuring a suitable system of controls is designed and is operating effectively. They should be actively involved in monitoring the government's compliance with material laws and regulations.</i></p> <p>Management should make it clear through personal actions and policy statements the importance of ethical and honest behavior. If management is unable to communicate this message it is doubtful that they can remove or reduce incentives for an employee to engage in dishonest, illegal, or unethical acts.</p> <p><i>An active and effective governing board, or committees thereof, provides an important oversight function and, because of management's ability to override system controls, the board plays an important role in ensuring effective internal control.</i></p> <p>The board should constructively challenge management's planned decisions and probe for explanations of past results (e.g., budget variances).</p> <p><i>The philosophy and operating style of management normally have a pervasive effect on an entity.</i></p> <p>Management should move carefully, proceeding only after carefully analyzing the risks and potential benefits of a venture. If management does not move carefully there is an increased risk that they might violate budgetary laws that could result in the misappropriation of funds and illegal expenditures.</p> <p><i>The organizational structure should be neither so simple that it cannot adequately monitor the entity's activities nor so complex that it inhibits the flow of necessary information.</i></p>	

<b>General Compliance Environment Considerations Applicable to All OCS Chapters</b>	
<b>Area for Assessment</b>	<b>Comments</b>
<p>Non-elected officials, senior management, and others in key management positions (particularly those directly responsible for compliance with material laws and regulations) should fully understand their control responsibilities and possess the requisite experience and levels of knowledge commensurate with their positions.</p> <p><i>Management must specify the level of competence needed for particular jobs, and translate the desired levels of competence into requisite knowledge and skills.</i></p> <p>Management should analyze, on a formal or informal basis, the tasks comprising particular jobs, considering such factors as the extent to which individuals must exercise judgment and the extent of related supervision. If employees are not trained and they do not know what is expected of them, there is an increased risk of error which could result in material non-compliance.</p> <p><i>The assignment of responsibility, delegation of authority and establishment of related policies provide a basis for accountability and control, and set forth individuals' respective roles.</i></p> <p>Management should assure employees understand the scope of their assigned duties. If management is unable to communicate to an employee his or her responsibilities, it is doubtful that they can reduce the likelihood of unnecessary mistakes made by employees.</p> <p><i>Human resources policies are central to recruiting and retaining competent people to enable the entity's plans to be carried out so its goals can be achieved.</i></p> <p>Management should establish personnel policies and procedures that result in recruiting or developing competent and trustworthy people necessary to support an effective internal control system. If management does not strive to hire competent people, there is an increased risk that an employee may engage in dishonest or illegal acts.</p> <p><u><i>The human resource function should specify minimum requirements for positions.</i></u></p> <p><u><i>The human resources function should have written job descriptions for employees.</i></u></p>	

<b>General Compliance Environment Considerations Applicable to All OCS Chapters</b>	
<b>Area for Assessment</b>	<b>Comments</b>
<b>Audit implications and/or management comments:</b>	

<b>Budgetary (OCS Chapter 1)</b>	
<b>Area for Assessment</b>	<b>Comments</b>
<p>The following factors may influence the auditor's assessment of risk of significant non-compliance with budget laws and regulations:</p> <p>Management develops strategic plans and budgets to monitor the activities of the entity. To be effective, these plans and budgets should be realistic, based on valid assumptions and developed by knowledgeable individuals. Management must also have sufficient reliable information on a timely basis to review and evaluate the entity's operations.</p> <p><i>Consider for example, the following points of focus:</i></p> <ul style="list-style-type: none"> <li>- <i>Existence of a budgetary monitoring system and compliance function</i></li> <li>- <i>Attitudes towards compliance with budgetary laws and regulations</i></li> <li>- <i>Governing authority and management's involvement in the internal control structure to assure compliance with budgetary laws and regulations.</i></li> <li>- <i>The effectiveness of the budget process (i.e. segregation of duties for budget preparation, adoption, execution and reporting).</i></li> <li>- <i>The level of detail and informational value of plans and budgets and of financial, statistical, or other information used by management with respect to:</i> <ul style="list-style-type: none"> <li>· <i>its relevance to the respective manager's responsibilities,</i></li> <li>· <i>its sufficiency,</i></li> <li>· <i>the frequency and timeliness with which it is received, and</i></li> <li>· <i>its reliability.</i></li> </ul> </li> <li>- <i>Appropriate involvement of personnel, for example:</i> <ul style="list-style-type: none"> <li>· <i>both senior management and lower-level personnel,</i></li> <li>· <i>managers, for activities relating to their respective areas of responsibility, and</i></li> <li>· <i>suitably knowledgeable and experienced personnel (such as operating line management).</i></li> </ul> </li> <li>- <i>The comparison of current conditions or results with appropriate benchmarks (e.g., the preceding year's conditions or results, or a practicably achievable budget or plan, etc.).</i></li> <li>- <i>The intended purpose of plans and budgets (e.g., to reflect management's reasonable expectations or to serve as "motivational" tools reflecting unrealistic targets).</i></li> <li>- <i>The assumptions underlying strategic plans and budgets; that is, whether they:</i> <ul style="list-style-type: none"> <li>· <i>reflect the entity's historical experience and conditions currently affecting operations, and</i></li> <li>· <i>are consistent and are communicated to the appropriate</i></li> </ul> </li> </ul>	

<i>Budgetary (OCS Chapter 1)</i>	
Area for Assessment	Comments
<p><i>personnel.</i></p> <ul style="list-style-type: none"> <li>- <i>The past record of the entity in meeting plans and budgets.</i></li> <li>- <i>The effectiveness of monitoring performance with respect to:</i> <ul style="list-style-type: none"> <li>· <i>documentation of significant departures from plans, with explanation,</i></li> <li>· <i>evaluation of explanations by the appropriate levels of management or the governing authority,</i></li> <li>· <i>implementing corrective actions by appropriate levels of management and follow-up by senior management.</i></li> <li>· <i>timeliness of consideration of the effect of changes in the economy, industry, and competition,</i></li> <li>· <i>indication and timeliness of corrective actions,</i></li> </ul> </li> <li>- <u><i>An accounting system that integrates budgetary accounts to provide continuous information regarding available appropriations and estimated resources not yet received.</i></u></li> </ul> <p>Note: <u>The AICPA’s State &amp; Local Government Audit Guide, 11.25 &amp; .26 cautions the auditor to consider whether the government uses its budget to control spending or instead, uses spending to establish (i.e. amend) the budget. Many governments do the latter, in which case analytical procedures relating to the budget may not be valid support for financial position and activity statement assertions.</u></p>	
<p><b>Audit implications and/or management comments:</b></p>	

<i>Contracts and Expenditures (OCS Chapter 2)</i>	
Area for Assessment	Comments
<p><b><i>Points of Focus</i></b></p> <ul style="list-style-type: none"> <li>- <i>Existence of a contract and expenditures monitoring system and compliance function</i></li> <li>- <i>Attitudes towards compliance with contract and expenditures laws and regulations</i></li> <li>- <i>Legal actions brought against the entity, elected and non-elected officials related to contract compliance.</i></li> <li>- <i>Governing authority's and management's involvement in the internal control structure to assure compliance with contracts and expenditures laws and regulations.</i></li> </ul>	
<p><b>Audit implications and/or management comments:</b></p>	

<i>Debt (OCS Chapter 3)</i>	
Area for Assessment	Comments
<p style="text-align: center;"><i>Points of Focus (Debt)</i></p> <ul style="list-style-type: none"> <li>- <i>Existence of a debt monitoring system and compliance function</i></li> <li>- <i>Attitudes towards compliance with debt laws and regulations</i></li> <li>- <i>Legal actions brought against the entity, elected and non-elected officials</i></li> <li>- <i>Governing authority's and management's involvement in the internal control structure to assure compliance with debt laws and regulations</i></li> <li>- <i><u>Willingness to use bond counsel or other specialists (e.g. arbitrage specialists) when issuing debt.</u></i></li> <li>- <i><u>Accounting system suitably designed to comply with any requirements to separately account for debt proceeds or debt service payments.</u></i></li> </ul>	
<p><b>Audit implications and/or management comments:</b></p>	

<i>Accounting and Reporting (OCS Chapter 4)</i>	
Area for Assessment	Comments
<p><b>Points of Focus</b></p> <ul style="list-style-type: none"> <li>- Existence of a monitoring system and compliance function</li> <li>- Attitudes towards compliance with accounting and reporting laws and regulations</li> <li>- Legal actions brought against the entity, elected and non-elected officials</li> <li>- Governing authority's and management's involvement in the internal control structure to assure compliance with accounting and reporting laws and regulations.</li> <li>- <u>Accounting system suitably designed to accommodate the volume of transactions, the requirements to separately account for restricted resources, and that integrates budgetary reporting.</u></li> <li>- <u>Accounting staff sufficiently trained and knowledgeable of laws and applicable accounting and reporting requirements.</u></li> </ul>	
<p><b>Audit implications and/or management comments:</b></p>	

<b>Deposits and Investments (Chapter 5)</b>	
<b>Area for Assessment</b>	<b>Comments</b>
<p><b>Points of Focus</b></p> <ul style="list-style-type: none"> <li>- <i>Existence of a deposits and investments monitoring system and compliance function</i></li> <li>- <i>Existence of a written investment policy and an investment committee to monitor compliance</i></li> <li>- <i>Attitudes towards compliance with deposits and investments laws and regulations</i></li> <li>- <i>Legal actions brought against the entity, elected and non-elected officials</i></li> <li>- <i>Governing authority's and management's involvement in the internal control structure to assure compliance with deposits and investments laws and regulations.</i></li> <li>- <u><i>Basic knowledge of laws restricting investment instruments, or a practice of referring to ORC 135 and written investment policies, and knowledge of the features and risks of investments prior to purchasing them.</i></u></li> <li>- <u><i>Sufficient cash flow planning to avoid investment losses resulting from insufficient liquidity. (For example, investing all available cash in a 5 year instrument could require selling it at a loss prior to maturity if the government needs the cash before the five-year maturity.)</i></u></li> </ul>	
<p><b>Audit implications and/or management comments:</b></p>	

<b>Other Potentially Direct and Material Laws and Regulations (OCS Chapter 6)</b>	
<b>Area for Assessment</b>	<b>Comments</b>
<p><b>Points of Focus</b></p> <ul style="list-style-type: none"> <li>- Existence of an appropriate monitoring system and compliance function</li> <li>- Attitudes towards compliance with indicated laws and regulations</li> <li>- Legal actions brought against the entity, elected and non-elected officials</li> <li>- Governing authority's and management's involvement in the internal control structure to assure compliance with indicated laws and regulations.</li> <li>- <u>Accounting system suitably designed to provide information when needed, such as information related to insurance claims, landfill closure or postclosure costs.</u></li> <li>- <u>Suitable systems and procedures for collecting other financially significant information reliably, such as landfill usage, student attendance statistics.</u></li> </ul>	
<p><b>Audit implications and/or management comments:</b></p>	