



February 9, 2015

Audit Report No. 15-12

Martha Tate, President
TS'AHBII KIN CHAPTER
P.O. Box 1755
Kaibeto, Arizona 86053

Dear Ms. Tate:

The Office of the Auditor General contracted REDW, CPAs to conduct a Local Governance Act (LGA) certification review of the Ts'ahBii Kin Chapter five management system. The purpose of the review was to determine whether Ts'ahBii Kin Chapter has met the objectives of a five management system per LGA as defined by 26 N.N.C. The review has determined that material weaknesses exist within the Chapter's five management system. Consequently, the auditors have issued an unfavorable recommendation to the Chapter's pursuit of LGA certification.

Background

26 N.N.C. §101 requires chapter management to adopt and operate under a five management system. As such, the management of the chapter is responsible for establishing and maintaining a five management system that provides reasonable assurance that:

- Financial transactions are authorized, valid and properly recorded to permit the preparation of basic financial statements and other financial reports.
- Assets are safeguarded against loss from unauthorized disposition or use.
- Chapter activities in the areas addressed by its five management system comply with applicable laws and regulations.

Scope, Objectives and Methodology

The review included obtaining an understanding of the internal control policies and procedures established by the Chapter's five management system, evaluating the design effectiveness of the internal control procedures, determining whether such procedures have been placed in operation, and any other procedures we consider necessary to form a conclusion on whether the Chapter has met the objectives of a five management system.

The LGA defines a five management system to include accounting, procurement, record keeping, personnel, and property management. During the review, Ts'ahBii Kin Chapter's achievement of its five management system objectives in the areas of financial reporting, safeguarding of assets and compliance with laws and regulations were evaluated.



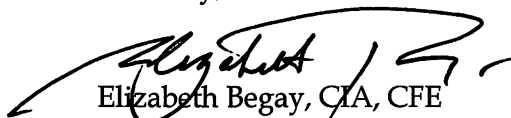
Review Results

Due to the material weaknesses found within the Ts'ah Bii Kin Chapter five management system, the Office of the Auditor General hereby issues an unfavorable recommendation not to certify the Chapter as defined by 26 N.N.C. The attached list of deficiencies resulted in this unfavorable recommendation.

Conclusion

Although the Ts'ah Bii Kin Chapter has established the basic foundation for a five management system, the implementation of this system is hampered by various internal control deficiencies. These deficiencies do not allow the Chapter to provide reasonable assurance for proper accountability and fiscal responsibility over Chapter operations and activities. Attached is a management letter from REDW, CPAs listing the material weaknesses found during the review along with recommendations to resolve the deficiencies and improve Chapter operation. Once the Ts'ah Bii Kin Chapter has addressed these deficiencies, the Chapter can submit another request for an LGA certification review.

Sincerely,



Elizabeth Begay, CIA, CFE
Auditor General

Attachment

- xc: Geraldine Chee, Vice-President
- Joshua Tate-Robins, Secretary/Treasurer
- Jonathan Nez, Council Delegate
- Earl Sombbrero, Community Services Coordinator
- TS'AH BII KIN CHAPTER**
- Robert Begay, Department Manager II
- ADMINISTRATIVE SERVICE CENTER**
- Chrono

Office of the Auditor General – Navajo Nation

*Inscription House
Internal Audit & Consulting Report
July 2014*

REDW^{LLC}

CPAs | Business & Financial Advisors

Inscription House Internal Audit & Consulting Report

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Inscription House Internal Audit & Consulting Report

Elizabeth Begay, Navajo Nation Auditor General
Office of the Auditor General – Navajo Nation

INTRODUCTION

We performed the internal audit and consulting services described below to assist the Office of the Auditor General – Navajo Nation in evaluating the Inscription House Chapter’s (the “Chapter”) compliance with the Five Management System (FMS) as defined by 26 Navajo Nation Code (N.N.C), the Local Government Act. REDW performed these internal audit and consulting services in conformity with the AICPA Statements on Standards for Consulting Services. Such services were not attest services, as defined in “Statements on Standards for Attestation Engagements – Attestation Standards”, nor do they constitute an audit, review or compilation of the Chapter’s financial statements, internal controls, or any component thereof.

PURPOSE AND OBJECTIVES

REDW obtained an understanding of the Chapter’s internal control policies and procedures established by the FMS. By following the FMS Policies and Procedures Checklist for the minimum internal controls, REDW evaluated the Chapter’s implementation and adherence to the FMS minimum internal controls to determine whether 1) financial transactions are authorized, valid, and properly recorded to permit the preparation of basic financial statements and other financial reports, 2) assets are safeguarded against loss from unauthorized disposition or use, and 3) Chapter activities in the areas addressed by its FMS policies and procedures adhere to applicable laws and regulations. We performed this engagement to identify any internal control weaknesses and to report on the implementation of the FMS minimum policies and procedures as outlined in the Checklist.

SCOPE AND PROCEDURES PERFORMED

Policies & Procedures and Interviews:

In order to gain an understanding of processes and controls in place at the Chapter, we read applicable policies and procedures as well as interviewed and received information from the following personnel:

- a) Earl Sombrero, Chapter Service Coordinator
- b) Evalia Besog, Accounts Maintenance Specialist

In addition, we obtained a further understanding by (1) reading and understanding the FMS standard manual provided by the Office of the Auditor General – Navajo Nation, (2) evaluating the design effectiveness of the Chapter's placement of procedures to comply with the manual, and (3) evaluating and testing the Chapter's implementation of the procedures in place. These steps were performed to assess whether the Chapter had met the objectives of the FMS and to recommend certification within the meaning of 26 N.N.C. Section 102 based on our work and analysis performed.

Sample Selection and Testing: The time period tested was January through March 2014. For each FMS Policy and Procedure Checklist area listed below, we performed a variety of testing procedures to assess whether controls were in place and functioning as intended. These procedures included, but were not limited to:

- 1) Selecting one to five payroll disbursements, cash disbursements, cash receipts, new employees, vendor contracts, travel requests and purchases and testing the underlying support to determine if the transaction and documentation adhered to the FMS requirements.
- 2) Physically observing a fixed asset, inventory on-hand, the records, including personnel files, maintained on-site, cash and checks on-hand, and bank signature cards to determine if they were appropriately safeguarded.
- 3) Assessing the adequacy of the accounting ledgers, journals and financial statements, reconciliation procedures, and the budget approval and monitoring process to determine if the current structure and controls allowed for accurate financial data and controlled expenses.
- 4) Physically observing the implementation of the records management system designed by Chapter management and assessing the process to determine adherence to the FMS.

Below are the topics for the minimum internal controls, as based on the FMS Policies and Procedures Checklists, which were included in our testing:

General Administrative Policies & Procedures

General Administrative System

Fiscal Management Policies and Procedures

Accounting System

Budget Process

Cash Receipts Process

Petty Cash Process

Investment Process

Disbursement Process

Payroll Process

Travel Process

Financial Assistance Process

Bank Accounts Process

Resale Process

Fixed Assets Process

Financial Reporting Process

Property Management Policies and Procedures

Property Management System

Property Acquisition

Property Inventory

Property Maintenance and Storage

Property Rental and Utilization

Property Disposition

Personnel Management Policies and Procedures

Personnel Management System

Employment Practices

Recruitment and Selection Process

Employment Status

Classification of Positions

Salary and Wage Administration

Overtime

Employee Benefits

Employee Performance Appraisal

Discipline of Employees

Employee Grievance Process

Termination of Employment

Procurement Management Policies and Procedures

Procurement System

Purchase Request Process

Receiving Process

Emergency Purchase Process

Contracting Process

Records Management Policies and Procedures

Records Management System

Record Filing/Classification Methods

Record Accessibility/Retrieval

Record Backup/Storage

Record Disposal

For each topic listed, adequate minimum internal control procedures were identified based on the Checklist, confirmed against the FMS policy and procedures manuals, and tested for both written and design implementation at the Chapter.

OBSERVATIONS

In the course of performing testing, the following observations were identified for the Chapter:

Policy & Procedure Observations

Personnel Management

- **Tracking of Independent Contractors** – The FMS policy did not define requirements for independent contractor classifications or the tracking of such contractors. The Checklist described a minimum internal control to identify and appropriately classify independent contractors.

- Recommendation – Policies should be updated to include the requirements for independent contractor classifications and the process for maintaining a listing of those contractors. The Chapter should maintain a listing of independent contractors to mitigate the risks of related party transactions and other compliance risks.

Operational Observations

Fiscal Management

- **Segregation of Duties: Disbursements** – Signed disbursement checks were being returned for mailing to the Clerk who was responsible for setting up vendors, processing disbursements and preparing the checks for signature. There were mitigating controls in place that would likely identify inappropriate disbursements prior to signature; however, the checks could be altered after returning for mailing.
 - Recommendation – Controls over disbursements would be improved if all signed checks were sent directly to an individual who is independent of the disbursement and check preparation process. Alternatively, the Chapter Manager or Treasurer could review all cancelled checks with the bank statement to ensure they were not altered and that the endorsements appear reasonable.
- **Segregation of Duties: Pay Rates** – The Account Maintenance Specialist (AMS), who was responsible for processing payroll, printing payroll checks for signature, and distributing the signed payroll checks, was also responsible for changing pay rates and setting up new employees in the system. There were mitigating controls in place that would likely identify ghost employees; however, it is unlikely that those controls would identify inappropriate small pay rate changes.
 - Recommendation – Consider assigning someone independent of the payroll process to update pay rates and set up new employees in the system, and restrict access for those that process payroll. Alternatively, implement a process where pay rates applied to disbursements are reviewed by the Chapter Manager or Treasurer during the check review process.
- **Cash Receipts Reconciliation** – There was no documentation indicating that a review of the cash receipts reconciliation was performed by the Chapter Service Coordinator (CSC) in January 2014, and the Cash Receipts Journal, which is essential to the reconciliation process, was not on file to allow for the reconciliation to occur. This missing journal would have also prevented a full reconciliation from being performed by Chapter Treasurer. Cash receipt reconciliations are required by the FMS policies and procedures and mitigate the risks related to the lack segregation of duties. Without adequate reconciliation and review controls over cash receipts, cash could be misappropriated and go unnoticed.
 - Recommendation – All cash receipt support, including the Cash Receipts Journal, should be maintained to ensure that a full cash receipt reconciliation can occur. The CSC the Chapter Treasurer should document that the reconciliation is performed each month.
- **Segregation of Duties: Cash Receipts** – The AMS, who was responsible for receiving payments, issuing receipts to Community members, and posting cash receipts to the general ledger, was also responsible for preparing the bank reconciliation. In addition, at times, the CSC was completing the cash receipts process. There were mitigating controls in place that would likely identify theft of cash receipts including the reconciliations performed by the

CSC and Chapter Treasurer; however, as discussed above, documentation was not on file to show that these reconciliations were consistently occurring.

- Recommendation – As documented above, a full reconciliation of cash receipts to the bank statement and general ledger should be performed and documented on a monthly basis by someone independent of the cash receipts process. All variances should be investigated.
- Cash Deposits – Cash receipts were not deposited in a timely or consistent basis. All receipts for the month of January 2014 were not deposited until mid-February 2014.
 - Recommendation – Cash receipts should be deposited in a timely manner to reduce the risk of theft.

Procurement Management

- Purchase Orders – There was no formal process in place to identify and approve purchases prior to incurring the expenditure. Supporting documentation for expenditures tested was dated after the actual expenditure occurred. This creates the risk of budget overages, unallowable purchases and inefficient use of resources, as the best price may not be obtained.
 - Recommendation – Chapter management should follow the FMS policies and procedures by obtaining vendor quotes/bids and preparing the Fund Approval Form for review and approval prior to purchasing goods/services needed for the Chapter. This will ensure that there are adequate funds available in the budget, the best price is obtained, and the risk of misappropriation of assets is minimized.
- Receiving Reports – There was no process in place to document that items purchased were actually received (i.e. receiving reports). Without a formal process for comparing what was purchased to what was received, there is the risk that goods could be stolen or not received, and the discrepancy would not be identified by the Chapter.
 - Recommendation – Chapter administration should assign someone independent of the purchasing process to verify all goods upon receipt. Documentation of the comparison between what was purchased/ordered and what was ultimately received should be documented through the use of a receiving report.

Records Management

- Records Inventory – The FMS requires that all records are inventoried and placed on a rotating disposal cycle based on the type of records. The Chapter had not performed a full inventory of records on-hand, and there was not a process in place for adhering to the disposal cycle.
 - Recommendation – The Chapter should perform a full inventory of all records on-hand and set up a process to adhere to the rotating disposal cycle. Alternatively, the Chapter may consider moving to a digital electronic based system where information can be compressed and stored efficiently. Paper documentation may cause fire hazards.
- Backup Procedures – The Chapter was performing a critical backup of only the accounting system in accordance with the FMS. Despite the backup of essential and important accounting information, other essential and important information, such as sensitive human resource information, organizational records, and tax documentation were not duplicated and stored digitally off-site. In addition, the accounting backup was kept either on-site or taken home with an employee, which is not allowed by the FMS.

- Recommendation – Implement a process for ensuring that all critical information is backed up. The backup should be maintained off-site in a secure location such as a bank safety deposit box.
- Record Requests – The Chapter did not have a formal record request process to properly document and track the various informational requests by community members. Not tracking records requested puts the Chapter at risk for allowing access to protected records without proper authorization and documentation.
 - Recommendation – The Chapter administration should follow the FMS policies and procedures to ensure that community members and outside parties are only allowed access to appropriate records with documented authorization from Chapter administration.

Property Management

- Preventative Maintenance – The Chapter did not employ a schedule of preventive maintenance on equipment and buildings. Documentation maintained on-site did not provide any indication of maintenance performed on large assets essential to the operations of the Chapter.
 - Recommendation – The Chapter should draft and implement a preventative maintenance schedule on equipment and buildings in order to ensure the assets are kept in satisfactory condition and to detect or prevent failures before they occur.
- Equipment & Facility Rentals – The Chapter did not have a process in place for approving the rental of equipment and Chapter meeting space. This includes obtaining and documenting Chapter management approval of the rental and documenting the inspection of the property for damage after the property had been used. This exposes the Chapter to the risk that damage may occur to Chapter property, and it will not be detected timely resulting in the Chapter being liable for the damage.
 - Recommendation – The Chapter should utilize the Chapter House Usage Form as the form documents the requirements for the rental of Chapter facilities, such as approval from Chapter management, proof of renter liability coverage and inspections of Chapter property before and after use.

CONCLUSION

The engagement did not include an evaluation of the Chapter’s operational effectiveness and efficiency beyond the FMS. We did not perform an audit in accordance to Generally Accepted Auditing Standards, and as such, we express no opinion on the financial position of the Chapter. We provide no conclusion regarding the effectiveness and efficiency of the overall Chapter’s operations. We also did not perform any procedures to specifically identify fraud or irregularities. Should we note such activities based on our testing, we would report them to you.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described in the FMS and was not designed to identify all deficiencies in internal control that might be material weaknesses.

Based on the testing performed herein, we conclude that the combination and severity of deficiencies identified in the observations above rise to the level of a material weakness. The Chapter's implementation of the FMS does not adequately ensure that financial reporting is reliable and reasonable, assets are safeguarded from loss, and the Chapter complies with applicable laws and regulations. Therefore, we recommend that the Resource and Development Committee (RDC) not approve the Chapter for governance certification within the meaning of 26 N.N.C. P102. Although we have provided the recommendation to not certify the Chapter, the ultimate responsibility for recommending pass or fail will be made by the Office of the Auditor General of the Navajo Nation.

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This report is intended solely for the information and use by the Office of the Auditor General of the Navajo Nation Council, the Chapter, and others within the Navajo Nation Government for the purpose of governance certification under the Local Governance Act. This report and the procedures applied are not intended to be for, and should not be used by, anyone other than these specified parties.

We received excellent cooperation and assistance from the Chapter personnel during the course of our testing. We very much appreciate the courtesy and cooperation extended to our personnel. We would be pleased to meet with you to discuss our findings and answer any questions.

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REDW LLC

Albuquerque, New Mexico
August 1, 2014