

Excellence in Management

Strong Control Environment; Strong Internal Controls

Issue: Tredyffrin Township needs a strong control environment and strong internal controls over its operations and financial processes to promote efficiency, reduce risk of asset loss, and help ensure the reliability of financial statements and compliance with laws and regulations.

Definitions Provided by COSO:

- ❖ The Committee of Sponsoring Organizations (COSO) (<http://www.coso.org>) is an independent private sector initiative dedicated to improving the quality of financial reporting through business ethics, effective internal controls, and corporate governance. COSO produces an internal control framework that is widely used in the US; it is this framework that is generally considered an underpinning of the Sarbanes-Oxley Act.
- ❖ According to the COSO framework, organizations need a strong control environment. Control environment factors include 1) the integrity, ethical values and competence of the entity's people; 2) management's philosophy and operating style; 3) the way management assigns authority and responsibility, and organizes and develops its people; and 4) the attention and direction provided by the board of directors. This control environment is set by senior members of an organization – ie the “tone at the top” – which includes senior management and the Board of Directors.
- ❖ COSO defines internal controls as “a process – effected by an entity’s board of directors, management and other personnel – designed to provide reasonable assurance regarding the achievement of objectives in the following categories: 1) effectiveness and efficiency of operations, 2) reliability of financial reporting, and 3) compliance with applicable laws and regulations.”

Our Position: We believe that our township needs a stronger control environment, and that the Board of Supervisors needs to set higher standards for proper internal controls over our township's operations and financial processes. We also believe, in light of the two embezzlements that our township experienced in recent years, that our Supervisors must make an extra effort to prove to us – the residents of Tredyffrin Township – that they are serious about improving our township’s internal controls. The following actions should be effected immediately:

- **The Township’s Ethics Policy should be adopted.** We understand that an Ethics Policy has been written but has not yet been formally adopted. An Ethics Policy is management’s written commitment to provide a strong control environment. The township’s Ethics Policy should go beyond merely describing the basic civility we expect from each other (ie responsiveness, dependable, open & accessible, etc) but should also include strong policies on conflicts of interest, and gifts/gratuities/donations. The Ethics Policy should require that an annual conflict of interest report be provided by key employees and officials, and that gifts, gratuities, and donations to key employees or officials (or to the political parties who support them) from those who do business with the township (including those who are significant related parties of those who do business with the township) be disclosed on the township’s website. The township’s Ethics Policy should be reviewed, revised as necessary, formally adopted, and – to enhance transparency with the residents – posted on the township’s website.

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- **Background checks should be performed on all key employees and officials.** Our township's finance team is relatively small and therefore one of the key components of internal controls – the proper segregation of duties – is often hard to attain. As a result, a great deal of trust is placed in the integrity, ethical values and competence of the entity's people. Background checks can help ensure that that trust is well-founded. We understand that our township has decided not to perform background checks on certain key employees. We believe that background checks should be performed on all key employees and officials.
- **Annual Certifications of Financial Integrity should be obtained from key employees and officials.** This recommendation is a direct result of the two instances of embezzlement that our township experienced in recent years. We understand that this recommendation was given to our Board of Supervisors but our township has decided against implementing it. We believe that key employees and officials should sign a form as part of an annual review process certifying:
 - They have not been arrested or convicted of a crime;
 - They have not been sued as a defendant in a law suit
 - They have not filed for Bankruptcy
- **The recommendations of the Lamb Report should be implemented, with progress reports posted on the township's website.** As a result of two instances of embezzlement in recent years, the Board of Supervisors established the Tredyffrin Township Task Force headed by Pennsylvania Supreme Court Justice William H. Lamb. Although the Supervisors pledged to adopt the findings of the Task Force, to date - almost three years after the report was submitted to the Supervisors - many of the critical recommendations have not yet been implemented. We believe the recommendations in the Lamb Report should be implemented, and – to enhance transparency with the residents – the Lamb Report, along with management's responses, should be posted on the township's website.
- **Reports of all Management Letters of Findings and Recommendations prepared by the external auditors – along with management's responses – should be easily obtainable by the township's residents.** For the year ended 2004 our township's senior management received an extensive letter from our external auditors listing the various weaknesses in our township's internal controls. Those weaknesses were listed almost verbatim a year later – with many items not yet implemented. Even as recently as earlier this year many of the items on these previous letters were still not implemented . We believe that a “clean” Management Letter is a worthy and proud goal to achieve, and – to enhance transparency with the residents – all Management Letters, along with management's responses, should be reported on the township's website or otherwise made easily obtainable by the township's residents.
- **The township should more fully utilize its elected Auditor.** According to the township's website, the elected auditor has historically fulfilled this role merely by meeting with the external auditors and reporting on those meetings. Our Home Rule

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Charter clearly states that the elected auditor should audit the township's financial accounts and reports. Considering the two instances of embezzlement that our township experienced in recent years, we believe that the elected auditor should review monthly financial information and perform other monitoring procedures to help ensure the integrity of the township's financial records and reports. The elected Auditor should report any findings and recommendations to the Board of Supervisors on a periodic basis and – to enhance transparency with the residents – report those findings on the township's website.

- **The Board of Supervisors should hire an external CPA firm to perform a full review and testing of the existing internal controls.** The regular annual audit provides only a limited review of internal controls. Now, almost three years after the Lamb Report was submitted, the township should undergo a rigorous review of its internal controls. The results of this work should be posted on the township's website.

Background: In 2003, Stephen M. Pandolfi, who worked as a bookkeeper in the township's finance group, pleaded guilty and was sentenced to prison for embezzling \$13,000 of township funds. In 2005, township Finance Director Harry Marrone (who worked with Pandolfi) pleaded guilty and was sentenced to prison for embezzling over \$70,000 in township funds. Marrone had previously served a jail sentence for income tax evasion - in fact he served the 5-month sentence for that conviction while on medical leave from Tredyffrin. The township was unaware of Marrone's prior conviction because a background check had never been performed on him, and when asked how a township employee could take leave to serve a prison sentence and then return to his position, previous Board chairman John G. Bravacos commented "If someone says they're going out for medical leave, I don't know how you would go about questioning that." ("Ex-finance director took medical leave to serve jail time," *Philadelphia Inquirer*, 9/8/04).

According to the *Suburban & Wayne Times* ("Marrone sentenced to 11-23 months" 6/16/05) "Supervisor Judy DiFilippo said Marrone took 'items that no one was looking for,' including rebates on equipment, payment of parking tickets, utility-company fees and funds Chester County paid the township to reimburse the police department for overtime for members of the county drug task force."

These instances of embezzlement demonstrate how inadequate internal controls led to significant losses for our township – not just once, but twice. As a result, our Board of Supervisors needs to prove to us – the residents of Tredyffrin Township – that they are committed to providing a strong control environment and strong internal controls. They can do this by following the guidelines provided in this report.

If you have any questions or comments about this issue, please contact Glenda Yu, Candidate for Township Auditor, or Maria Micolucci (<mailto:info@tdems.com>). Specific references for information contained in this white paper are available on request.