**MEMORANDUM**

**DATE : July 12, 2016**

**TO:** **All Local Government Officials**

**FROM:** **Jerry E. Durham, CPA, CGFM, CFE**

**Assistant Director, Division of Local Government Audit**

**SUBJECT: *Tennessee Code Annotated*, 9-18-102(a); Required Internal Control Policies and Procedures**

Our office has received several questions about the internal control policies and procedures that are required by *Tennessee Code Annotated*, Section 9-18-102(a). I am writing this memo to clarify the Division of Local Government Audit’s (LGA) position relative to the new state statute:

1. A system of internal control is required for the year ended June 30, 2016. The system of internal control must be documented in writing.
2. Governments are not required to submit their internal control policies and procedures to LGA or any other state agency.
3. LGA has established an Internal Control and Compliance Manual based on the U.S. Government Accountability Office’s (GAO) Green Book. <http://comptroller.tn.gov/la/InternalControl.asp>.
4. As indicated in the Preface to the manual, the principles and examples are not mandatory. They are designed to give you some idea of what is involved in establishing an internal control system, with **one exception** (See number 5 below).
5. **Every system of internal control must include the five components of internal control: a) Control Environment; b) Risk Assessment; c) Control Activities; d) Information and Communication; and e) Monitoring. Each of these components is described in LGA’s Internal Control and Compliance Manual.**

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1. Some officials may be familiar with the internal control checklists that have been prepared by LGA. These checklists can be used and adapted for a number of situations that involve segregation of duties. Segregation of duties falls under the “Control Activities” component of internal control. Utilizing the checklists does not establish a system of internal control because the checklists do not address all five components of internal control listed above. <http://comptroller.tn.gov/la/InternalControl.asp>
2. Your Auditors should ask whether or not your government has developed and documented a system of internal control as required by state statute and U.S. Office of Management and Budget’s (OMB) Uniform Guidance. LGA has recommended to CPA Firms that, if local governments have not made a good faith effort to document and implement a system of internal control, this should be at least a management finding. If internal controls are very poor, the finding might be elevated to a significant deficiency or material weakness.
3. Those charged with governance (TCWG; e.g. County Commission or City Council) are not required to approve the internal control policies and procedures. LGA believes it is preferable for TCWG to play a role in emphasizing the importance of internal controls and indicating their desire that each department establish a system of internal controls, perhaps by resolution. In other words, to set the “tone at the top.” LGA does not believe TCWG should write the policies and procedures. We believe this the responsibility of management. However, each government has total discretion in this matter.
4. LGA believes that local governments receiving federal financial assistance (e.g. grants) have more responsibilities for internal controls under OMB’s new Uniform Guidance than before. For example, more controls over procurement and monitoring subrecipients. Each local government needs to download and read OMB’s new Uniform Guidance. <https://cfo.gov/cofar/cofar-resources/>

This message was sent to the email addresses LGA utilizes for contract communication purposes, and therefore, may not include some officials who need to be aware of the changes to internal control requirements.