Internal Audit Report

Cuyahoga County, Ohio
Department of Internal Auditing

Office of Budget Management
Encumbrance Process
January 2023

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**CUYAHOGA COUNTY
DEPARTMENT OF INTERNAL AUDITING**

Office of Budget Management (OBM) – Consulting Engagement Memo
Encumbrance Process Review
January 6, 2023

To: County Fiscal Officer Michael Chambers; Office of Budget Management Director Walter Parfejewiec; and the current management of the Cuyahoga County Fiscal Office:

The Cuyahoga County Audit Committee requested the Department of Internal Audit (DIA) to assess the design of controls within management action plans being implemented by the Office of Budget Management (OBM) due to repeated Management Letter Comments (MLC) in the 2020 and 2021 external single audit of Cuyahoga County regarding budgetary compliance. The MLC's specifically referenced non-compliance of the following:

- ORC 5705.39 requiring total appropriations from each fund shall not exceed the total of the estimated revenue available for expenditure.
- ORC 5705.36(A)(4) requiring when revenue to be collected by the County will be less than the amount in an official certificate and that amount of deficiency will reduce available resources below the level of current appropriations, the fiscal officer shall reduce estimated resources for the deficiency.
- ORC 5705.41(B) requires expenditures be limited by appropriations.

MLC's also noted that the ERP system was permitting some of the noncompliant situations. DIA's assessment was performed as a consulting engagement. We were not engaged to and did not conduct an audit examination.

This consulting engagement was performed in accordance with the *International Standards for the Professional Practice of Internal Auditing* issued by the Institute of Internal Auditors (IIA). The IIA standards define consulting engagements as advisory and related management services/activities, the nature and scope of which are agreed with and/or requested by management and is intended to add value and improve the County's governance, risk management, and control processes without the internal auditor assuming management responsibility.

OBM-Encumbrances

Encumbrances are restrictions placed on the use of funds. Encumbrances are used to ensure that there will be sufficient money available to pay for specific obligations. Encumbrance entries are a method to assure a government entity will not over-extend its finances and it ensures accounting for the anticipated expenditure is done.

The County currently has the following process for encumbrances:

- At the beginning of the year, OBM records appropriations within the County Financial System (Lawson).
- Department managers are asked to review the appropriations and budgets within Lawson.
- At year-end, appropriations not used are reduced through decertification. Previously, encumbrances in FAMIS had been rolled over to the next year.

Purpose and Scope of Work

The purpose of this consulting engagement was to assess the process to be used by OBM to manage compliance with Ohio Revised Code relative to appropriations and encumbrances. DIA reviewed the issues noted in the single audit Management Letter Comments, inquired about OBM current processes and plans for addressing noted issues, inquired about policies and procedures relating to budgetary controls, and researched potential controls to have in place to correct noted issues. Our work was performed as of 12/31/2022 and any subsequent remediation efforts or actions taken by management after this date may not be reflected in this report.

OBM Plan of Action as of December 2022:

The following steps have been or were to be taken by OBM to address noted compliance issues relating to encumbrances and appropriations:

- All remaining unspent contract balances on the current year contract lines are to be decertified by year-end (and recertified in the following year). OBM and the Fiscal Office contacted the Information Technology (IT) Department and G Force (consultant used to help with Infor/Lawson issues). They were informed that there was no automated solution to help close outstanding encumbrances by County IT personnel. G Force consultants communicated to County Fiscal Office that automated solutions may be available, but no definitive solutions have been identified.
- Without an IT solution, OBM will ensure that manual decertification of all contracts occurs. They will contact Executive agencies to assist them with the decertification of their contracts. OBM does not have the authority to compel non-Executive agencies to decertify their own contracts; however, they will request assistance.

- Per OBM, this will remove approximately 80-85% of the total year-end encumbrances. Purchase Orders will remain open at year-end until the end of the first quarter of the following year.
- With most encumbrances removed, appropriations will then also be reduced.

Findings and Recommendations:

This report summarizes our findings and recommendations as they relate to our evaluation of the OBM encumbrance process:

- There were no established procedures to manually remove encumbrances by the relevant departments.

- Per the County's third-party technical consultants, an automated solution for decertification of unspent contract balances on the current year contract lines at year-end (and recertified in the following year) is not available.

- During the assessment, the Fiscal Office advised that appropriations would be updated quarterly going forward. This process was not formally adopted within policies and procedures or in practice.

- OBM's plan to decertify all unspent contract balance encumbrances by year-end 2022 does not include Purchase Orders. The risk of potential non-compliance for being over-encumbered remains due to the exclusion of Purchase Orders when decertifying.

- There was an override of the Budget Edit control by DoIT that resulted in budgetary non-compliance and led to an external auditor finding.

- The ERP system currently lacks a control to ensure adequate budget is available for expenses with encumbrances _carried over from the prior year_ (e.g. Requiring OBM approval or an automated review). This is an important control to prevent possible over-spending.

- Monitoring is available within the Infor system to compare expenditures and encumbrances to appropriations and estimated resources. Reporting that is performed by the County Fiscal Office does not include encumbrances, so it does not show the County as being out of compliance.

Based on the above findings DIA recommends the following:

- Fiscal Office should continue to work with consultants to ensure the effective use of automation within Lawson system in managing the appropriation and encumbrance processes.
- As further automation is not feasible, OBM should establish a process that will require and provide guidance to all Executive agencies in the removal of all open encumbrances when appropriate. Additionally, OBM should establish a process to ensure all encumbrances that must be carried over from the prior year are included within the current year budget. This process should include effective communication including completion timeframe and instructions. OBM should monitor the process to ensure that

all contracts are timely decertified and if necessary, perform the requisite decertification or budget adjustments.

- The responsibility of performing year-end encumbrance decertification should be limited to appropriate staff within OBM and staff at departments that will need to perform decertification functions. Roles and responsibilities should be designed with the principle of least privilege, which dictates users should only have access to the minimum information required to perform their assigned duties. IT should not have write access to perform transactional activity within the organizational accounting system without appropriate pre-approval and oversight.

- Implement a control to ensure contracts and/or purchases have sufficient budget available within the department for expenditures. This includes accounting for encumbrances in place when updating existing contracts.

- Establish a process to ensure that appropriations and encumbrances for Purchase Orders are in compliance with ORC.

- Update and formally adopt policies and procedures relating to encumbrances and appropriations. This includes having regular monitoring of fund balances, appropriations, encumbrances, and estimated resources. In addition, the process for how and when encumbrances will be removed.

DIA would like to thank OBM and the Fiscal Office for their cooperation and effort in working towards a solution to ensure compliance with Ohio Revised Code and proper budgetary controls.

Sincerely,

Monica Houston, CPA, CGMA, CIA, CIDA
Director of Internal Audit

Cc: Audit Committee
        Cuyahoga County Council
        Eric Janas, Chief of Staff
        Richard Manoloff, Law Director
        Andy Johnson, Chief Information Officer
        Katie Gallagher, Chief of Operations and Community Innovation
        Michael O'Malley, Cuyahoga County Prosecutor