Taking financial oversight to **a higher level**

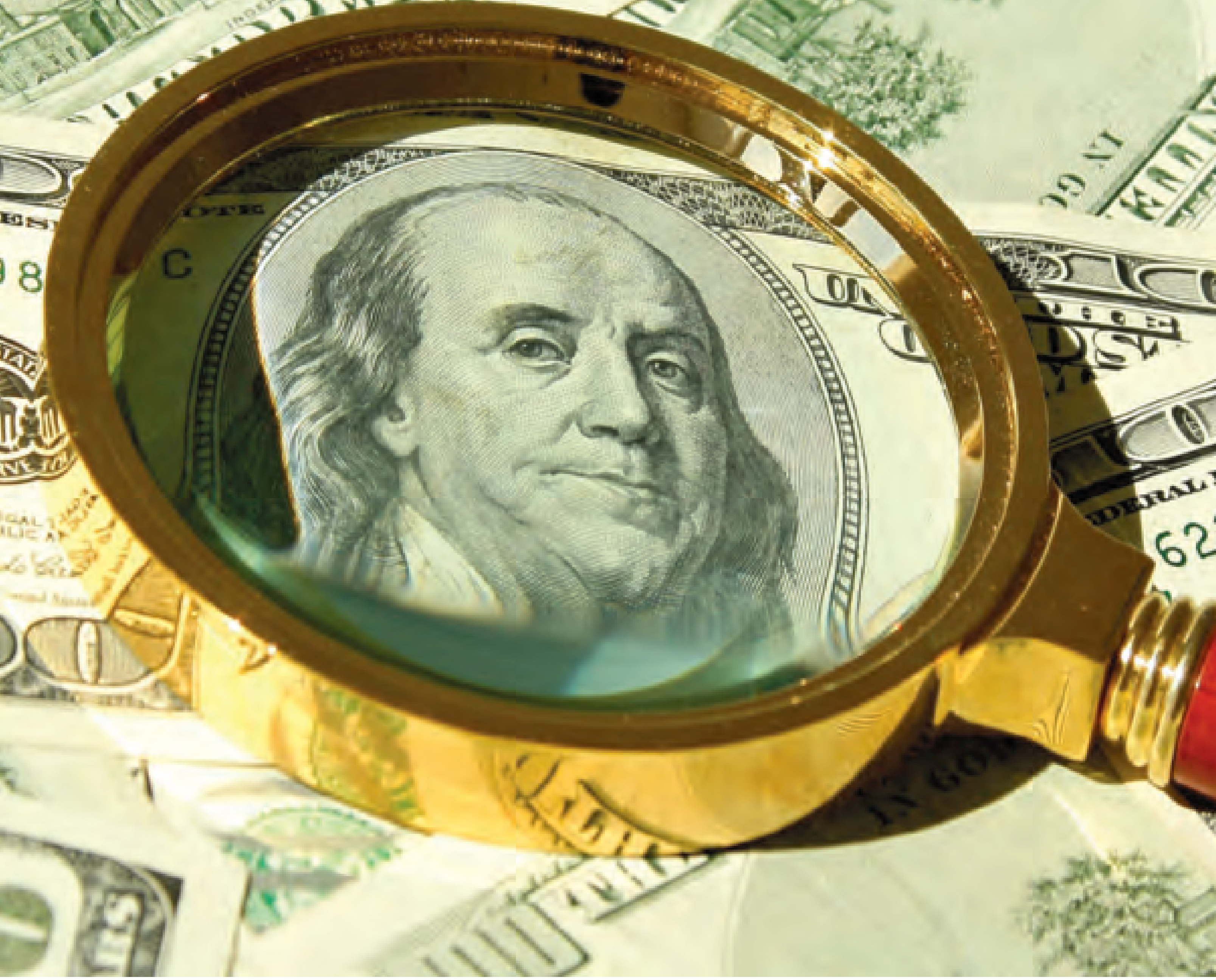
Effective financial oversight is generally a fundamental responsibility of governing boards in every sector of society—private and public, but especially in the public. Township boards are explicitly charged by law to exercise meaningful oversight of major financial functions and decisions, including authorizing expenditures, acquiring and disposal of township property, and budget adoption and amendments.

According to the Spring 2018 Michigan Public Policy Survey (MPPS) conducted by the Center for Local, State and Urban Policy at the University of Michigan, almost 9 out of 10 responding township officials comprised of township supervisors, managers and clerks give their board "good" or "excellent" ratings for effectively overseeing township finances. That level of confidence appears well deserved, given that most townships are notably absent from lists promulgated by the state Department of Treasury of Michigan local governments experiencing documented fiscal stress.

Keeping your township out of fiscal difficulty is not the only objective of comprehensive financial oversight. Even one township experiencing embezzlement or theft is one too many, especially if it is yours. Unfortunately, local governments are not immune from the increase in criminal actions of persons in position of trust. Even the best financial oversight cannot prevent all misdeeds, but it does give the township a much better chance of minimizing any losses.

But the full scope of activities essential for boards exercising their fiduciary duties goes well beyond adequate financial oversight. All members of the township board are considered the township electors' trustees—to act on behalf of the public interest, to make prudent decisions and not expose the township to undue risk. A board in fiduciary mode is working together as opposed to board members acting individually. Self-appointed "watchdogs" generally don't know what to look for and can do considerable unnecessary harm when they focus too much on finding misdeeds instead of taking steps to prevent bad things from happening.

The township board, acting collectively, has the legal and moral standing to adopt policies that drive the township to high performance and efficiency, and avoid undesirable outcomes. The township board as an employer is charged with managing risks through policies and actions that promote employee safety, legal compliance and honesty.



This article outlines the basic components of financial oversight expected of township boards, but also suggests additional roles for township boards to perform when they are in "fiduciary mode." A board's fiduciary mode is described in *Governance as Leadership; Reframing the Work of Nonprofit Boards* by governance expert Richard Chait (BoardSource, 2005). Written primarily for non-profit organizations, its principles are easily applicable to other governing boards such as local governments.

Financial oversight is not the board's only job

Township boards practice the basic elements of financial oversight—such as budget development and adoption and reviewing financial reports—on such a regular basis that it becomes second nature. It is less common that other elements of financial oversight—monitoring implementation of internal controls, for example—are also routinized into a systematic monitoring schedule. And the higher functions

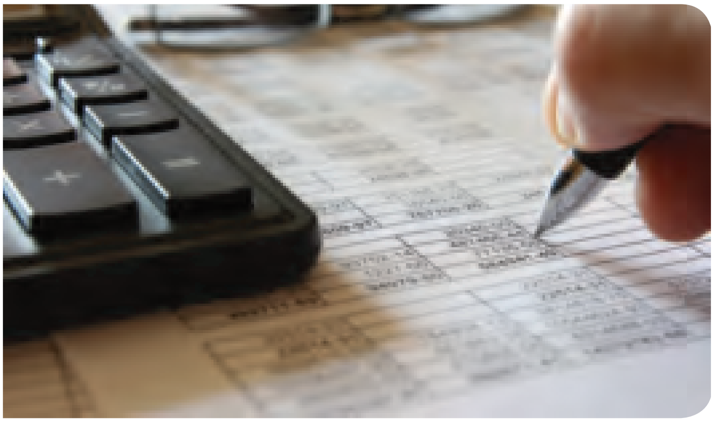
This continuing education article and accompanying self-assessment are worth 2.0 elective credits in MTA's Township Governance Academy. See page 22 for details.

OBJECTIVE

- To outline the basic components of financial oversight expected of township boards, and suggest additional roles for township boards to perform a higher level of fiduciary management.

CORE COMPETENCIES

- Aware of financial matters affecting the township
- Possesses effective policy-making and decision-making skills
- Understands the budget process, financial statements and how to use fiduciary responsibilities to manage the township's affairs in the best interests of the public



Boards that pride themselves on effective financial oversight go beyond the statutory basics and make fiduciary monitoring and evaluation functions ongoing and regular board meeting activities.

of boards in what Chait, *et al* call "fiduciary mode" are too often missing from agendas of all sorts of public bodies. Nonetheless, boards that frequently engage in full fiduciary mode reach higher levels of public service than those that limit themselves to basic financial oversight.

Setting an example

In fiduciary mode, the township board sets an example for department heads and their subordinates for the degree of care owed to taxpayers for the wise use of their money and holding everyone in the organization—including the township board itself—accountable. The board carefully identifies, scrutinizes and chooses from multiple options to make decisions that best serve the public. Ethical considerations and identifying the greater good are routinely interjected in board policy discussions. Board members demonstrate their commitment to operate in the township's best interest rather than their own and act appropriately when conflicts of interest arise.

87%

Percent of township officials who give their board good or excellent ratings for effectively overseeing township finances

Statistics source: MPPS

Townships that take their fiduciary duties seriously include financial oversight as a regular element of their board meetings. Financial oversight requires all township board members to be familiar with the extensive list of statutes and regulations *(see sidebar on page 19)* that impose legal obligations on the board to direct and monitor financial activities. But township boards in fiduciary mode go beyond mere financial oversight to establish additional expectations on township officials and employees that clarify through policies what is to be accomplished, set priorities, and articulate limitations on activities and actions that create undue risks to the township. Boards in fiscal mode monitor township operations to ensure their policies are being followed, and adjust their policies in response to new information and changing circumstances.

Financial oversight and periodic financial reports

Effective financial oversight requires that the township board regularly receives and analyzes timely financial reports. Typically, township boards receive monthly reports of fund balance sheet reports, current and year-to date revenue and expenditures reports with budget appropriation comparisons, and an investment status and performance report demonstrating compliance with the board's statutorily mandated policy. Townships may find that a cash flow report is also helpful. However, reports are of little use unless the board takes the time to analyze the information to determine if the township's financial position is consistent with board expectations. Financial data that is not compared to benchmarks is of limited value. And equally important, the board needs to pay attention to trends—are numbers changing in ways that indicate all is well or that foretell potential future financial difficulties? In fiduciary mode, financial reports are not merely "received and filed," but questions are raised, resolved and appropriately responded to through board financial policies.

16%

Percent of township officials who think township's general fund balance to be too low

Townships under 4,000 population are required by state law to have an audit every other year, while all other township audits must be conducted annually. However, townships that qualify for the biannual audit should nonetheless consider opting for annual audits because biennial audits must include an examination of financial records back to the conclusion of the prior audit, and boards need more frequent verification and assurance of the township's financial position.

Internal controls

Township boards in fiduciary mode ensure that there are effective internal procedures in place to timely and effectively correct financial transaction errors and minimize the township's exposure to theft and embezzlement, which according to news reports are on the rise in organizations of all nature. Lax financial controls that create the opportunity for bad things to happen reflect poorly on governing boards.

Township boards should not solely rely on outside auditors to detect fiscal chicanery, as only a very small percentage of fraud and embezzlement are caught by external audits. Auditors sample financial transactions and clever people can find ways to hide their misdeeds for years. Absent effective internal preventive procedures, fraud and embezzlement are often caught after the person responsible leaves their position and fresh eyes catch the missing money, or officials in other tax-levying entities note that their property tax collections remitted by the township are less than expected.

Effective financial oversight by township boards includes making sure that appropriate internal controls are in place. Township officials who have little or no prior experience in financial administration likely lack expertise in procedures to achieve effective internal controls, but the township's auditors can provide recommendations that township boards need to ensure are implemented, and that may require the township board to provide additional resources to improve accounting procedures. And while insistence of internal controls is the township board's collective responsibility, it falls to clerks, treasurers and their deputies to faithfully implement them.

33%

Percent of townships experiencing an increase in general government operation needs this year

36%

Percent of townships expected to increase general government operations spending next year

Internal controls require instituting some redundancies in recording financial transactions and fund custody so problems and errors are more likely detected and corrected, and it is often common for officials to resist instituting internal controls as a waste of time and unnecessary. This is especially true in organizations where everyone knows each

State law requirements for boards regarding township finances

As the newly formed State of Michigan organized its government structure in the years following statehood, township boards first appeared in the Constitution of 1856 and continued through the current Constitution of 1963. But if you sought in the Michigan Constitution illumination as to what township boards are supposed to do, your answers would remain essentially unanswered:

> *"In each organized township there shall be elected for terms of not less than two nor more than four years as prescribed by law a supervisor, a clerk, a treasurer, and not to exceed four trustees, whose legislative and administrative powers and duties shall be provided by law." (Article VII, Section 18 of the Michigan Constitution of 1963)*

And if you did a word search in the Michigan Compiled Laws or on Google, you would find a long list of a multitude of statutes implying or explicitly stating that township boards have a strong role in and responsibility to ensure that township finances are appropriately managed. While state laws charge clerks and treasurers with authority and responsibility to record financial transactions and custody of township funds respectively, a multitude of statutes make clear the township board, acting collectively, is responsible for serving as the "watchdog" on township affairs on behalf of the township electors and in compliance with state laws.

Unfortunately, the Legislature has never codified all of these various statutory duties and responsibilities into one easy-to-locate state law, but MTA staff have identified the following laws as key statutes identifying the statutory duties of township boards relative to financial oversight and fiduciary duty:

- Uniform Budgeting and Accounting Act, PA 2 of 1968; MCL 141.425 *(requirement to have a budget and an audit)*
- Budget Hearings of Local Governments, PA 43 of 1963
- Investment of Surplus Funds of Political Subdivisions, PA 20 of 1943
- Credit Card Transactions, PA 266 of 1995 *(township use of credit cards)*
- Financial Transaction Device Payments, PA 280 of 1995 *(township acceptance of credit card payments)*
- Payment of Wages and Fringe Benefits, PA 390 of 1978 *(board, as employer, responsibility for payroll frequency)*
- MCL 41.65 *(clerk's financial responsibilities)*
- MCL 41.75 *(board must approve all claims)*
- MCL 41.76 *(treasurer's financial responsibilities)*
- MCL 41.77 *(treasurer responsible for depositing moneys, board depository resolution)*
- MCL 41.78 *(treasurer accounts for receipts and expenditures)*
- MCL 41.110 *(transfer of unexpended balances)*
- MCL 41.110a *(board must use Uniform Chart of Accounts)*

Also see the Michigan Department of Treasury's *Accounting Procedures Manual* and *Budget Manual for Local Units of Government*.

other well and trust—whether well placed or not—abounds. But townships, regardless of size, can encourage and enable stronger internal controls by authorizing more compensable hours for staff necessary to properly segregate duties such as timely and independent reconciliation of check registers and bank statements. However, in some townships—especially smaller entities that do not have large staffs—individual board members such as the township supervisor can be assigned by the board to perform tasks that improve internal controls, such as reviewing check registers and bank statements when there are not enough other staff to ensure appropriate independent oversight.

Ensuring accountability for quality performance

Boards that pride themselves on effective financial oversight go beyond the statutory basics and make fiduciary monitoring and evaluation functions ongoing and regular board meeting activities. Township boards in fiduciary mode should set the proper moral tone and assure township-wide consistency and coordination to ensure that resources are efficiently deployed. Strong financial performance can only be achieved when the township board clicks into fiduciary mode to articulate not only what is unacceptable, but also what is to be accomplished.

To ensure that expenditures and uses of other township resources are focused on the things that are most important, the township board can establish an explicit mission statement that serves as the compass for the board and others to keep the township focused on what is most important. The board assures faithfulness to mission, acknowledges that it is accountable to the township's electors for the performance of all township functions, and monitors activities for compliance with laws and regulations and proper stewardship of township finances and property.

13%

Percent of township officials who evaluate their township in perfect fiscal health

Looking inward and outward

While the book *Governance as Leadership; Reframing the Work of Non-Profit Boards* (BoardSource, 2005) wasn't written with local government boards in mind, its authors Richard P. Chait, William P. Ryan and Barbara E. Taylor suggest that boards in fiduciary oversight mode look inward for trouble and outward for financial purposes:

Board looking **inward** for trouble:

- Can expenditures be afforded?
- Is audit clean and unqualified?
- Is budget balanced?
- Legal compliance?
- Staff turnover at acceptable levels?
- Revenue to be raised
- Monitor financial position
- Assure appropriate financial controls

Board looking **outward** for financial purposes:

- Opportunity cost of expenditures
- Alignment of budget and priorities
- Alignment of programs to mission
- Ethics
- Alignment of revenue streams to mission

Compensation benchmarked to the labor market

Townships in fiduciary mode ensure that the taxpayers "get their money's worth" through delivering services at a reasonable cost. A major amount of the taxpayer's money is used to compensate officials and employees. Township boards have primary responsibility to establish compensation levels that achieve desired results, which for most townships means compensation at levels sufficient to attract competency and minimize costly turnover. To find the "sweet spot," township officials need to know what other organizations pay similar positions so that township remains competitive while avoiding paying more than necessary to attract the kind of employees the township needs to achieve its mission.

51%

Percent of townships increasing employee pay next year

Boards evaluate their own performance

Townships and other local government governing boards are not only responsible to ensure that administrators do their jobs correctly, they are responsible for their own decisions and conduct relative to financial transactions and financial position. The township board plays an integral role in the township's financial management. If it is appropriate for the township board to hold others accountable for their activities, it is also appropriate in its fiduciary mode to evaluate its own performance.

This article suggests ongoing board activities to perform financial oversight at a high level and can serve as a checklist by which the board can objectively evaluate whether it is doing the job to the degree township taxpayers deserve.

Larry Merrill,
MTA Executive Director

See page 22 for a continuing education self-assessment, worth two elective credits in MTA's Township Governance Academy. To learn more about TGA, visit www.michigantownships.org/members (under the "Training" tab).

Major township board financial oversight functions

The following are among the most significant requirements of township boards related to financial oversight and recommended implementation practices, according to MTA staff:

- Adopt an annual budget prior to the ensuing fiscal year that appropriates sufficient financial resources to township activities while maintaining appropriate financial reserves.
- Budget must be monitored at least monthly and amended as soon as needed and known.
- Approve all financial transactions for legality compliance with budget appropriation and authorized by township policy or by explicit board approval.
- Property acquisition, use and disposal.
- Audit payment of claims with sole exception of current year tax collection disbursement account, prior to issuance, unless authorized by narrow board "post-audit" policy. Board members must have opportunity to review documentation provided including check/payment number in numerical order, voided payments, payee, amount, purpose, Chart of Accounts number where posted. Bills should not be approved in aggregate without itemized examination prior to vote. May approve payment of bills using consent agenda if all other review and examination procedures are followed prior to vote and board has had opportunity to discuss.
- Mandating and monitoring internal controls required by *Accounting Procedures Manual*, including segregation of duties, requiring clerk and treasurer financial reporting, clerk and treasurer reconciling, etc.
- Act if board becomes aware that a board member or staff are not complying with internal controls such as clerk or treasurer accessing or controlling financial records in a way that violates segregation of duties, not reconciling regularly, or treasurer not providing required reports/documentation for tax collection disbursement account to clerk.
- All expenditures or uses of township property, assets, etc. must be done as "lawful expenditures"—must be authorized by statute (expressly stated or fairly implied)
- Monies restricted by law cannot be used for other purposes.

Continuing education self-assessment

Participants enrolled in the Township Governance Academy (TGA), MTA's credentialing program, may obtain two elective credits for successful completion of this quiz. (To receive credit, this quiz must be completed by November 1, 2021.) To obtain credit, participants must answer the following 10 multiple-choice questions by circling the correct answer and receive a minimum passing score of 70 percent. The questions are based on content from the article, "Taking financial oversight to a higher level," beginning on page 16. There is no charge for MTA members to take the quiz or to obtain TGA credit. Completed quizzes should be faxed to (517) 321-8908 or mailed to: MTA, PO Box 80078, Lansing, MI 48917-0078. MTA will notify you of your results within two weeks after receiving your quiz. IMPORTANT: Please keep a copy of your completed quiz in your TGA binder. For information about TGA, call (517) 321-6467, email tga@michigantownships.org, or visit www.michigantownships.org/members (under the "Training" tab).

TGA continuing education—November 2018
Taking financial oversight to a higher level

NAME: ______________________ **TOWNSHIP & COUNTY:** ______________________

EMAIL ADDRESS: ______________________

1. As township boards practice the basics of financial oversight, it is less common for certain elements, such as ___________, to become second nature.

a. Budget development
b. Reviewing financial reports
c. Monitoring implementation of internal controls
d. Making prudent decisions

2. Boards engaging in full "fiduciary mode":

a. Consistently perform the basics of financial oversight.
b. Reach higher levels of public service.
c. Allow department heads to handle accountability for the use of taxpayer money.
d. Take care to follow *Robert's Rules of Order* when discussing financial matters.

3. When receiving financial reports, township boards should:

a. Take the time to analyze the information.
b. File the documents accordingly.
c. Avoid asking questions until the next report.
d. Stick to cash flow reports.

4. Why should township boards consider annual audits, even if they aren't required by law?

a. To reduce the workload for township employees.
b. To provide more frequent verification and assurance of their financial position.
c. To spot potential misconduct by employees.
d. To increase transparency with township residents.

5. To avoid embezzlement and fraud, township boards should:

a. Rely on outside auditors to detect problems.
b. Watch for property tax collections that are less than expected.
c. Regularly hire new staff who might catch the missing money.
d. Establish internal procedures to correct transaction errors and minimize risk.

6. When townships don't have the staff to perform redundancies such as reviewing check registers, another option is to:

a. Assign the tasks to individual board members.
b. Ask for community volunteers.
c. Hire a consultant.
d. Require overtime from current staff.

7. Township boards can only achieve strong financial performance if they create consistency by articulating:

a. A community vision plan.
b. Possible threats the board could face.
c. What is to be accomplished.
d. Five-year goals.

8. What is the value of a mission statement to a board's financial oversight?

a. It sets the moral tone for township employees.
b. It serves as a compass and keeps the township focused on what's most important.
c. It ensures compliance with laws and regulations.
d. It's a benchmark for proper stewardship of township finances and property.

9. What is the "sweet spot" for township employee compensation levels?

a. An above-average wage to attract the right employees.
b. A below-average wage out of responsibility to taxpayers.
c. Competitive with what other organizations pay while not paying more than necessary.
d. Competitive with the average wage for your township's region.

10. Who is responsible for evaluating the township board's performance?

a. A hired consultant
b. The board itself
c. Residents at a public hearing
d. Township employees