



# FINANCIAL MANAGEMENT REVIEW

DRAFT 3-21-2023

## **INTRODUCTION**

This report provides recommendations for the improvement of the District's Financial Management System. The recommendations are in response to the Audit for FY 20/21, that pointed to an overall weakness with Internal Controls, with emphasis on the Combined Schedule of Findings and Questioned Costs. Because of the overall critique of the District's internal controls, an evaluation and analysis was conducted of the District's current system in comparison to the Internal Control Guidelines established by the State Controller in 2015 (Guidelines). The evaluation found a number of weaknesses; this report offers recommendations to both address the specific issues raised in the Audit and to improve the overall financial management of the District. It is expected that the outcomes of following the recommendations will result in more robust financial management practices that reflect the financial activities of the District.

The evaluation described in the report follows the organization and wording of the Guidelines. Comments concerning the status of the District's Controls are either in **red**, if there is a problem, **blue**, if the current practices are in conformance, or **purple** if the practices are somewhat in conformance.

The recommendations are outlined in the summary and detailed at the end of the report.

## **SUMMARY**

The FY 20/21 Audit identified four significant issues: Segregation of Duties, Financial Reporting, Utility Billing, and Credit Card Purchasing

All relate to District's failure to meet some of the standards for internal control. To address these issues, District's policies, procedures and practices were evaluated using the California State Controller's Internal Control Guidelines. Results of the evaluation are the following recommendations to address the audit and improve the system.

### **1. Establish or improve policies for the following:**

- a. Control Environment
  - i. Organizational Ethics and Values
  - ii. Board Oversight and Board member Responsibilities
  - iii. Internal Communication
- b. Risk Management
- c. Control Activities
  - i. Authorization
  - ii. Performance reviews
  - iii. Information processing
  - iv. Physical controls
  - v. Segregation of duties
- d. Information and Communication
- e. Monitoring

### **2. Improve the accounting system to ensure proper fund accounting**

- a. Establish and new Chart of Accounts based on fund accounting
- b. Establish Bookkeeping procedures
- c. Determine and acquire the best accounting software to address the District's needs

### **3. Make personnel changes to improve the financial management system**

- a. Ensure job descriptions and job assignments provide for the necessary segregation of duties
- b. Add a part-time administrative help to allow the Administrative manager to have more time for financial responsibilities.
- c. Retain an accountant for monthly reporting, annual reporting, and advice
- d. Consider assigning one of the Board members the task of Treasurer

### **4. Provide additional training to the Administrative Manager, the General Manager, and Board members.**

## **Guidelines**

“The American Institute of Certified Public Accountants’ (AICPA’s) Auditing Standard AU-C §315.04 defines internal control based on the definition and description contained in *Internal Control – Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) as follows:

*A process effected by those charged with governance, management, and other personnel that is designed to provide reasonable assurance about the achievement of the entity’s objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Internal control over safeguarding of assets against unauthorized acquisition, use or disposition may include controls relating to financial reporting and operations objectives.*

Internal control is comprised of five components that work together in an integrated framework:

- Control Environment;
- Risk Assessment;
- Control Activities;
- Information and Communication; and
- Monitoring Activities.

The objectives of the five components are defined below along with examples of methods that may be used by a local government to address each component. However, these are guidelines and it is important to note that the actual methods implemented to address the components of internal control need to be scaled to each particular local government and expanded or contracted based on the local government’s organizational structure, staffing levels, programs, and resources. It is not expected that all local governments will use all of the example methods of implementation that have been identified for each component. In addition, some local governments may use other policies or procedures in their system of internal control in lieu of the examples provided in these guidelines.” (Guidelines)

## **Control Environment**

### **The Objectives of Control Environment:**

The AICPA's Auditing Standard AU-C §315.A71 defines control environment as:

*The control environment includes the governance and management functions and the attitudes, awareness, and actions of those charged with governance and management concerning the entity's internal control and its importance in the entity. The control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure.*

The control environment is the set of standards, processes, and structures that provide the basis for carrying out internal control across the entity. The governing board and management establish the "tone at the top" regarding the importance of internal control, including expected standards of conduct, which then cascade down throughout the various levels of the organization and have a pervasive effect on the overall system of internal control. The control environment extends beyond the idea of culture and comprises the following:

- The organization's integrity and ethical values;
- The governing board's oversight responsibilities;
- The assignment of authority and responsibility;
- The process for attracting, developing, and retaining employees; and
- The measures, incentives, and rewards to drive accountability for performance.

A local government's control environment is influenced by a variety of factors including its history, values, market, and the competitive and regulatory landscape. Also, a local government that establishes and maintains a strong control environment positions itself to be more resilient in the face of internal and external pressures.

There is an expectation that the Board and the staff share common values and ethics. However, there is no explicit expression or process that explains and reinforces a positive control environment.

### **Examples of Methods That May be Used by a Local Government to Address Control Environment:**

Local governments may use policies and procedures to promote and maintain a proper control environment. In some cases these policies and procedures are established as a matter of

practice. In other cases, these policies and procedures are in writing, perhaps in the form of a policy manual or an electronic library of documents to aid the local government in providing a basis for training personnel, communicating and providing a source of reference to approved policies, and maintaining consistency of recording financial transaction. A local government's policies and procedures should include some or all of the following elements:

#### *Organization's Integrity and Ethical Values*

1. Develop, widely distribute, and practice a code of conduct. **There District has a policy describing a code of ethics for the conduct of Board members. However the policy does not apply to staff members.**
2. Establish the values and operating style for the organization and communicate to all employees through various methods, such as by example, the code of conduct, policies, and procedures. **There is no set of values or established operating style.**
3. Consistently communicate to management personnel the importance of integrity and ethical values. **Because of the small size of staff, there is limited communication relating to integrity and ethical values. When its done it is usually associated with a performance review or disciplinary action.**
4. Ensure that the board and management receive and update their ethics training as required by AB 1234 **The clerk of the Board has kept the Board on track with annual training.**

#### *Governing Board's Oversight Responsibilities*

1. Identifies and accepts its oversight responsibilities. **There are no policies identifying the responsibilities of the members of the Board or requiring Board members to formally acknowledge responsibilities.**
2. Ensures that management has the skills, knowledge, and experience necessary for their job duties. **The Board reviews qualifications of management applicants as a part of the process of hiring the General Manager.**
3. Applies skepticism and is objective in evaluating management and when making decisions. **There is no policy to that effect.**
4. Ensures the completion of periodic risk assessments. **There is no policy or procedure.**
5. Follows up on the status of audit findings. **Board has followed up in addressing findings. However, there is no policy and no regular process to ensure that findings are addressed.**
6. Establishes an audit committee. **The District has no Audit Committee; it does have a budget and finance committee.**

### *Assignment of Authority and Responsibility*

1. Consider the structure of the organization in terms of its size and the nature of its operation. **The size of the organization is limited by funding and the availability of qualified personnel.**
2. Establish reporting lines to enable execution of authorities, responsibilities, and flow of information to manage the activities of the organization. **The small size of the organization facilitates clear lines of authority, responsibilities, and flow of information.**
3. Use appropriate processes and technology to assign responsibility and segregate duties as necessary at all levels of the organization. **The General Manager in consultation and approval of the Board assigns responsibilities and segregates duties.**
  - a. The governing board should retain authority over significant decisions and review management assignments and any limitations of management's authority and responsibilities. **The Board retains authority over all decisions and management assignments, authorities, and responsibilities.**
  - b. Management should establish directives, guidance, and control to enable management and other personnel to understand and carry out their internal control responsibilities. **These issues are addressed in policies, however additional policies are needed to address internal control.**
  - c. Personnel should understand the organization's operational style and the code of conduct and carry out management's plan of action to achieve the objectives. **There has been no formalized description of operational style, code of conduct or management plan of action.**

### *Process for Attracting, Developing, and Retaining Employees*

1. Establish policies and practices reflecting expectations of competence. **There are policies in the job descriptions.**
2. Evaluate competence across the organization. **Operators are required to stay current with credentials. There is no credentialing requirement for the Administrative Manager.**
3. Provide the mentoring and training needed to attract, develop, and retain sufficient and competent personnel. **Training is provided for operators to maintain credentialing. The GM and Admin Mgr. are provided training as the budget allows.**

- a. **Attract** – Seek out candidates who fit the organization’s needs and possess the competence for the position. **The location of the District combined with a limited financial ability impedes attracting the most qualified candidates.**
  - b. **Develop** – Enable individuals to develop competencies appropriate for assigned roles and responsibilities. Establish expectations and tailor training based on roles and needs. **Training is provided, however there has been no evaluation of training needs and gaps.**
  - c. **Mentor** – Guide employee performance toward expected standards of conduct and competence, and align the employee’s skills and expertise with the organization’s objectives. **Mentoring is part of the GM job also the current consultant provides mentoring.**
  - d. **Evaluate** – Measure the performance of employees in relation to achievement of objectives and demonstration of expected conduct. **Annual Performance reviews are conducted according to Policy**
  - e. **Retain** – Provide incentives to motivate and reinforce expected performance. **Incentives are limited by the size of the organization and budget.**
4. Develop contingency plans to ensure that candidates for succession are trained and coached for assuming the target role so that internal controls do not lapse. **Difficult due to the size and age of staff members. Further consideration of this issue is needed.**

#### *Accountability for Performance*

1. Establish mechanisms to communicate and hold individuals accountable for performance of internal control responsibilities across the organization and implement corrective actions as necessary. **Performance reviews are held annually. Step raises are tied to performance and credentialing**
2. Establish performance measures and incentives appropriate for responsibilities at all levels. **See above.**
3. Perform evaluations timely and align incentives with the fulfillment of internal control responsibilities. **See above.**

## **Risk Assessment**

### **The Objectives of Risk Assessment:**

The AICPA's Auditing Standard AU-C §315.A81 defines risk assessment as:

*An entity's risk assessment process for financial reporting purposes is its identification, analysis, and management of risks relevant to the preparation and fair presentation of financial statements.*

A local government's risk assessment process includes how management identifies risks (including fraud risk) relevant to the preparation and fair presentation of financial statements in accordance with the local government's applicable financial reporting framework, estimates the significance of each risk, assesses the likelihood of the occurrence, and decides upon actions to respond to and manage them and the results thereof.

Risks relevant to reliable financial reporting include external and internal events, as well as transactions or circumstances that may occur and adversely affect a local government's ability to initiate, authorize, record, process, and report financial data consistent with the assertions of management.

The District's Board and Management are aware of Risk and assume a "common sense" approach to the topic. However, the District would benefit from a more formalized process of assessing and addressing financial risk.

### **Examples of Methods That May Be Used by a Local Government to Address Risk Assessment:**

Below are examples of how a local government might manage its risk assessment process. These are only examples and some local governments might use other methods to meet the objectives of risk assessment:

1. Some local governments should address risk assessment in conjunction with the supervision of personnel. When providing direction to personnel in the performance of their duties, management may identify information as to the types of errors, policy violations, fraud, or noncompliance to which they should be attentive in the performance of their duties. This is the primary way the District manages risk. The approach relies on the knowledge, skills and abilities of the staff, particularly the General Manager.
2. Other local governments may have a more formal risk assessment process that includes one or more of the following elements: The District does not have a formal process to address risk.
  - a. The identification of objectives relevant to the reduction of errors, policy violations, fraud, or noncompliance. This is sometimes communicated to employees by means of

the posting of certain organizational policies and procedures. **This could be included in policy and training.**

- b. When errors or violations of policy occur or are identified, the local government should respond to this increase in risk by communicating to appropriate persons within the organization the need to be vigilant with respect to these identified areas of risk. **This is done, but on an informal basis.**
- c. The local government should report to department heads after each governing board meeting to communicate new or changed risks, conditions, actions, or events that may impact the ability of departments to manage the risks relevant to the operation. **Most staff attend all Board meetings.**
- d. Finance personnel should attend accounting training sessions to become aware of new accounting pronouncements and emerging issues in order to further identify and manage risks associated with proper financial reporting. **This should be provided as time and money allow.**
- e. Departments should send staff to conferences and program training sessions for the purpose of identifying likely risks of noncompliance, fraud, and error relevant to the programs that they manage. These persons should disseminate this information to other persons in their department. **Conference opportunities should be identified and pursued as needed.**
- f. The Information Technology (IT) department should periodically identify and communicate risks for which employees should be particularly vigilant. **We have not IT department.**
- g. Changes in software should be subject to extensive evaluation and testing in order to identify and manage risks associated with use. **Consultants are used for new software improvements. The ability to extensively evaluate software is very limited.**
- h. The budget should be used as a means to anticipate, identify, and react to changes in conditions that may increase the risk of misstatement. **Currently this perspective is not included in the budget development process.**
- i. During the year end closing process, the local government should identify for those personnel involved in the closing process the objectives of financial reporting and the likely errors that are associated with each individual's role in that process. This would include identifying the types of nonstandard transactions that merit special consideration or consultation to ensure that all aspects of generally accepted accounting principles associated with those transactions are properly attended to. **This is not specifically included in the responsibilities of the closing process.**

- j. Management should identify for its staff those parties that have transactions with the local government for which there is a potential conflict of interest due to members of management or elected officials having a relationship with those parties. [The Form 700 process as well as ethics training are intended to provide the Board members with sufficient sensitivity in this area.](#)
- k. Throughout the year, management maintains a list of information, conditions, transactions, and events that may increase the risk of accounting error or fraud in order to evaluate the effects of such matters and to properly communicate these matters to the local government's independent auditors. These include new laws or legislation, major changes in government operations, major or unusual transactions, actions of the governing board, new agreements, new joint ventures, asset impairments, new responsibilities for pollution remediation, major changes in executive management, staff reductions that might affect internal controls, major changes in the government's service area, the acquisition of utility systems, new material revenue sources or fee structures, changes in the collectability of loans made to others, regulatory inquiries or audits, significant intra-entity transactions, major changes in the local economy, etc. [This evaluation is done as part of the Audit preparation process.](#)

## Control Activities

### **The Objectives of Control Activities:**

The AICPA's Auditing Standard AU-C §315.A91 defines control activities as:

*Control activities are the policies and procedures that help ensure that management directives are carried out. Control activities, whether within IT or manual systems, have various objectives and are applied at various organizational and functional levels. Examples of specific control activities include those relating to the following:*

- *Authorization*
- *Performance reviews*
- *Information processing*
- *Physical controls*
- *Segregation of duties*

Local governments should establish policies and procedures to implement control activities that achieve management directives and respond to identified risks in the internal control system.

**The District has realized some issues related to its control activities. The latest audit has identified Segregation of Duties, Financial Reporting, Utility Billing, and Credit Card use.**

Control activities can be categorized as policies and procedures that pertain to the following:

*Authorization* – activities should be authorized in accordance with the local government's policies and procedures. **The District does authorize activities according to its policies and procedures. The District lacks sufficient policies, procedures and personnel resources to address the segregation of duties.**

*Performance Reviews* – local government should perform analyses of financial data, including comparing actual results to budget forecasts and historical data, to ensure variances are in accordance with expectations, considering internal and external factors. **The Board reviews financial reports monthly and does review the financial performance according to the current budget, However, the Board does not compare the current year with the prior year.**

*Information Processing* – two aspects, Application Controls and General IT Controls, which relate to the overall effectiveness of IT controls to ensure the proper operation of the local

government's information systems. **The District has a limited IT capability. There is not network administrative or financial system**

Application Controls are those related to procedures to check the accuracy of the output data, including follow-up on exceptions. Application controls are designed to help ensure completeness, accuracy, authorization, and validity of all transactions during application processing. It includes both the routines contained within the computer program code as well as the policies and procedures associated with user activities such as entering data and producing or reporting results. **The District lacks the technology and the staff to ensure the completeness, accuracy, authorization, and validity of all transactions.**

General IT Controls involve maintaining control procedures to restrict the access to the program data and the ability to make modifications to the data, including software updates and back-up or disaster recovery procedures, to ensure the continued operation of the information systems. General controls are needed to ensure the function of application controls, which depend on computer processing, and includes the structure, policies, and procedures that apply to the agency's overall computer operations. It applies to all information systems: mainframe, minicomputer, network, and end-user environments and can include controlled processes for system access, computer center or server operations, change management, incident response, business continuity, and backup and storage.

**The District has no formal control procedures to restrict the access to the program data and the ability to make modifications to the data, including software updates and back-up or disaster recovery procedures, to ensure the continued operation of the information systems.**

*Physical Controls* – include ensuring the safeguarding of both tangible and intangible assets. The local government should have policies that ensure the physical security over all assets, whether they be capital assets, cash and investments, or other assets, and procedures to periodically count or reconcile the assets to the records. In addition, access to computer programs or data files should be restricted to appropriate personnel.

**The District does have a policy for fixed asset accounting, however the policy has not been followed nor does it address computer programs or data files.**

*Segregation of Duties* – the functions of authorization, recording or reconciling, and maintaining custody of assets should be segregated.

When designing policies and procedures to address control activities, the local government should keep in mind that the cost of implementing certain control activities should not exceed the benefit derived from the control activities.

For some small local governments, segregation of duties may be a challenge. Review and approval by an appropriate second person may be the most important control activity. That second person may be a member of the governing body in a review or approval role.

(This was a major finding in the latest audit report. "In the areas of cash, utility billing, purchasing, payroll and fixed assets the District does not have sufficient staff to separate the authorization, recording and custody functions as would be required in the ideal system of internal controls. Individuals have duties which crossover conflicting areas of responsibility, such as custody of cash, as well as responsibility for recording and reconciling account activity, and authorizing transactions.")

### Examples of Methods That May be Used by a Local Government to Address Control Activities:

Below are examples of how a local government might implement control activities in specific areas. Each local government will need to identify control activities and areas of risk specific to the local government. These are only examples of key controls in the areas noted and some local governments might use other policies or procedures to meet the objectives of control activities in these and other areas.

- a. Cash Deposits
  - a. Bank reconciliations are effective tools to detect mistakes, errors, or embezzlements if they are prepared timely, reviewed in detail, and approved by a second person. Reconciliation is prepared by the Administrative Manager and reviewed and approved by the General Manager
  - b. Transfers between accounts involve two people (one to initiate and one to approve), to prevent misappropriation of assets. The Administrative Manager is generally the only one involved in transfers between accounts. Transfers to and from the LAIF investment account involve the GM and the Board of Directors.
  - c. To ensure proper segregation of duties, the person involved with the bank reconciliation should be prohibited from performing the following duties:
    - i. Collection of cash receipts in any form (cash, check, wire, electronic, credit card, etc.);
    - ii. Deposit of cash collections with the bank;
    - iii. Disbursements; and
    - iv. Authorized signer on the account(s).

The District does not have policy and procedure for the segregation of duties.

- b. Investments
  - a. The purchase or sale of investments should require authorization prior to execution, to ensure the transactions are in compliance with the local

government's investment policy, the Government Code, or any other authoritative guidance regulating the purchase or sale.

- b. To safeguard investments, an investment safekeeper should be utilized.
- c. Performance of the investment portfolio should be reviewed periodically to ensure it is meeting the objectives and expectations of the local government.

The District only makes investments through LAIF controlled by the State Controller.

- c. Payroll (Compensation-related Disbursements)
  - a. To ensure proper segregation of duties, access to the human resources module (add, delete, and modify employee data) should be segregated from access to the payroll module (payroll processing).

The District has insufficient staff to properly segregate duties.

- b. To ensure accuracy and authorization, a second person should be required to review and approve the following:
  - i. Timesheets;
  - ii. Addition or deletion of employees;
  - iii. Changes to the payroll data (existing employees);
  - iv. Time entry; and
  - v. Payroll register.

The GM and Administrative Manager combine to address all of the above. The Board is provided monthly payroll reports and have access to all timesheets.

- c. Internal financial reports should be reviewed and compared to budget on a periodic basis and variances should be investigated.

All financial reports are reviewed by the GM and most are reviewed by the Board. All significant variances are investigated and explained.

- d. Non-compensation-related Disbursements/Procurement
  - a. To ensure proper segregation of duties, access to the vendor database (add, delete, and modify vendor data) may be segregated from access to the accounts payable module (disbursements processing).

The District does not have policy and procedure for the segregation of duties.

- b. Invoices should be checked for mathematical accuracy and approved for payment prior to processing.

The Administrative Manager checks all invoices for accuracy. The General Manager reviews for approval. However the audit found that there was "... a lack of support for credit card purchases....caused by .."District personnel are not following established polices and procedures"

- c. Check/warrant registers should be reviewed for accuracy by a person independent from the accounts payable process and approved prior to finalization.

This is not done and relates to the lack of segregation of duties.

- d. Purchasing guidelines should be established that detail authorization limits, when contracts are required, and when purchases are subject to bidding or informal quotes. Otherwise, the applicable contract procurement sections of the Government Code, or other authoritative guidelines, should be followed.

The District has a purchasing policy that describes limits. The policies and government code are followed.

- e. Positive pay, or a similar procedure, should be employed.

The District does not use Positive pay.

- f. Internal financial reports should be reviewed and compared to budget on a periodic basis and variances should be investigated.

All financial reports are reviewed by the GM and most are reviewed by the Board. All significant variances are investigated and explained.

- e. Capital-related Expenditures

- a. Procedures should be established to ensure capital expenditures are authorized, identified, and capitalized.

All capital expenditures are initiated by the General Manager and reviewed and approved by the Board of Directors.

- b. Policies and procedures should be established to ensure that capital assets are safeguarded against misuse or theft.

The District has policies for the misuse and theft of District property

- c. Periodic physical inventories should be performed to ensure that the records are accurate and differences investigated/explained. Inventory counts should be performed by a person that is not responsible for safeguarding the assets and differences investigated/explained.

The District has a policy for fixed asset accounting which requires an annual inventory.

- d. Grant funded capital assets must be inventoried and maintained in accordance with applicable grantor requirements. The District relies on purchasing records related to grants, but does not keep separate inventories of grant assets.
- f. Revenue
  - a. To ensure proper segregation of duties, the person responsible for the collection of customer payments should be prohibited from being involved with, or having access to, the following:
    - i. Producing customer bills or reimbursement requests;
    - ii. Customer database (add, delete, and modify customer or rate data);
    - iii. Approving voided transactions; and
    - iv. Posting receipts to the general ledger.

The District does not have policy and procedure for the segregation of duties.

- b. Bills should be reviewed by a second person prior to issuance, on a sample basis at a minimum.

The District does include this step in its billing procedure due to the lack of policy and staffing.

This is a finding in the 20/21 audit: "...numerous errors in utility billing, such as incorrect customer counts, incorrect billing rates and unintentional duplicate billings....caused by...lack of oversight by the District office, which is due to a shortage of personnel to perform administrative duties of the office."

- c. When subsidiary ledgers are used, the detailed ledgers should be reconciled to the general ledger on a periodic basis and any differences investigated.

The District does not have subsidiary ledgers.

- d. Internal financial reports should be reviewed and compared to budget on a periodic basis and variances should be investigated.

All financial reports are reviewed by the GM and most are reviewed by the Board. All significant variances are investigated and explained.

- g. Debt

- a. Policies should be established to define when the governing body or staff may authorize the issuance of long-term debt, including bonds, capital leases, loans, lines of credit, etc.

There are no policies for the establishment of debt. The District has followed the requirements of the lenders...USDA and SRF.

- b. Procedures should be established to ensure timely repayment and compliance with on-going debt covenants.

The District strictly follows the debt repayment schedules for debt and has paid off debt ahead of schedule. There are no written policies or procedures that address this issue.

- c. To ensure compliance with limitations on use, the use of debt proceeds should be subject to review and approval. All use of debt proceeds have been in full compliance with the terms of loans. The use of proceeds have been subject to the review of the lenders. In the case of the SRF, the proceeds were disbursed on a reimbursement basis. The District was required to show proof of eligible expenditures prior to receiving reimbursement.

- d. Trustee or bank accounts should be reconciled by a person not involved with the authorization for the disbursement of debt proceeds.

The District has not needed a Trustee or bank accounts for debt proceeds as of yet. This may be a need in the future.

#### h. Financial Reporting

(This is a finding in the 20/21 audit. "Similar to many other small special districts, the District does not have policies and procedures in place to ensure that complete and accurate financial statement, MDSA and footnote disclosures are prepared in accordance with GAAP prior to the annual audit. Management relies upon the auditor to recommend footnote disclosures for the financial statements and to prepare adjusting journal entries for approval in order to report financial information in accordance GAAP. ")

- a. A policy should be used to establish budgetary control and approval required for budget amendments.

There is no policy that establishes budgetary control. To date, the District has never amended its budget.

- b. Financial reports should be reviewed for accuracy.

All financial reports are reviewed by at least two parties which include the General Manager, the Administrative Manager, the Accountant, and one or

more members of the Board of Directors. However there is no policy or procedure for the review of the various types of financial reports.

- c. Financial reports should be periodically produced and distributed or made available to departments and the governing body for review.

Financial reports are produced and distributed monthly.

- d. Analyses of financial data, including comparing actual results to budget forecasts and prior year actuals, should be performed to ensure variances are in accordance with expectations, considering internal and external factors. Any unexpected variances should be investigated.

The analysis of financial data does not include a comparison with prior years.

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## **Information and Communication**

### **The Objectives of Information and Communication:**

The AICPA's Auditing Standard AU-C §315.A84 defines the information system as:

*The information system relevant to financial reporting objectives, which includes the accounting system, consists of the procedures and records designed and established to:*

- *initiate, authorize, record, process, and report entity transactions (as well as events and conditions) and maintain accountability for the related assets, liabilities, and equity;*
- *resolve incorrect processing of transactions (for example, automated suspense files and procedures followed to clear suspense items out on a timely basis);*
- *process and account for system overrides or bypasses to controls;*
- *transfer information from transaction processing systems to the general ledger;*
- *capture information relevant to financial reporting for events and conditions other than transactions, such as the depreciation and amortization of assets and changes in the recoverability of accounts receivables; and*
- *ensure information required to be disclosed by the applicable financial reporting framework is accumulated, recorded, processed, summarized, and appropriately reported in the financial statements."*

The AICPA's Auditing Standard AU-C §315.A89 defines communication as:

*Communication by the entity of the financial reporting roles and responsibilities and significant matters relating to financial reporting involves providing an understanding of individual roles and responsibilities pertaining to internal control over financial reporting. It includes such matters as the extent to which personnel understand how their activities in the financial reporting information system relate to the work of others and the means of reporting exceptions to an appropriate higher level within the entity. Communication may take such forms as policy manuals and financial reporting manuals. Open communication channels help ensure that exceptions are reported and acted on.*

Information is necessary for an entity to carry out internal control responsibilities to support the achievement of its objectives. Management obtains or generates and uses relevant and quality information from both internal and external sources to support the functioning of other components of internal control. Communication is the continual, iterative process of providing, sharing, and obtaining necessary information. Internal communication is the means by which

information is disseminated throughout the organization, flowing up, down, and across the entity. It enables personnel to receive a clear message from management that control responsibilities must be taken seriously. External communication is twofold as it enables inbound communication of relevant external information and provides information to external parties in response to requirements and expectations.

Information is the data that is combined and summarized based on relevance to information requirements. Information requirements are determined by the on-going functioning of the other internal control components, taking into consideration the expectations of all users, both internal and external. Information systems support informed decision making and the functioning of the other components of internal control by processing relevant, timely, and quality information from internal and external sources.

An information system is the set of activities, involving people, processes, data and/or technology, which enable the organization to obtain, generate, use, and communicate transactions and information to maintain accountability and measure and review the entity's performance or progress toward the achievement of objectives.

**The information system is a weakness in the District. The problems include the limited staffing that does not afford sufficient time for all necessary financial tasks, the use of Qucikbooks (an accounting system designed for business, not government), and the chart of accounts which is not designed to fully capture the data needed to best describe the Dstrict's financial activity.**

A communication system consists of methods and records established to identify, capture, and exchange useful information. Information is useful when it is timely, sufficiently detailed, and appropriate to the user. Management should establish communication channels that: provide timely information; can be tailored to individual needs; inform employees of their duties and responsibilities; enable the reporting of sensitive matters; enable employees to provide suggestions for improvement; provide the information necessary for all employees to carry out their responsibilities effectively; convey management's message that internal control responsibilities are important and should be taken seriously; and convey and enable communication with external parties. Communication is not an isolated internal control component. It affects every aspect of an organization's operations and helps support the system of internal control. The feedback from this communication network can help management evaluate how well the various components of the system of internal control are working.

**Communication within the District is inconsistent. The small number of people required to run the District is a positive characteristic. The reliance on individual moods and personalities is**

both a strength and a weakness. Formal policies, systems, and protocols can be awkward and inefficient. Informality can be ignored and abused.

### **Examples of Methods That May Be Used by a Local Government to Address Information and Communication:**

Below are examples of how a local government might manage its information and communication. These are only examples and some local governments might use other methods to meet the objectives of information and communication:

1. Local governments may have management-authorized job descriptions for all personnel.

The District has job descriptions, however these descriptions do not address activities related to the internal controls for financial management.

2. Local governments may adopt policies and procedures to communicate important information about management's expectations for each process. Policies should be deployed thoughtfully and conscientiously to ensure that required actions are reasonable. Procedures should articulate the distinct responsibility and accountability of each individual involved in the process. Procedures lose effectiveness unless they are performed consistently, by qualified personnel who have been properly trained, and with a continuous focus on the risks to which they are directed. Related to the response to the previous example.

The District can adopt policies and procedures.

3. Local governments should adopt a written ethics policy or code of conduct and communicate management's message to employees concerning ethics through their daily words and actions.

The District does not have an ethics policy or a code of conduct for management and employees.

4. Management should periodically review pertinent policies with key employees charged with entering transactions into the financial system.

Management has been working with the Administrative Manager to interpret and improve the financial transaction processes.

5. Management should have access to viewing and reporting within the financial system and are encouraged to review their department's revenue, expenses, and budget-to-actual reports. Local governments should have monthly or quarterly reports distributed to department managers.

Financial reports are available to all District staff.

6. Management should provide written instructions to all financial personnel with a role in the budget development and year-end close processes. Instructions for the year-end close process should include the objectives of financial reporting and information about new accounting and financial reporting guidance.

There are no written instructions.

7. A mid-year financial report, or quarterly financial reports, should be submitted to the governing board for its review. This report of financial data can take various forms, including standard reports produced by that local government's accounting system or a high-level budget-to-actual comparison for selected key funds. An annual financial report, such as a Comprehensive Annual Financial Report (CAFR), is presented to the Audit Committee, if applicable, for its review and then presented to the governing board.

Monthly Financial Reports are submitted to the Board. However there is no mid year review.

8. Financial reports prepared for external distribution may be reviewed by management prior to distribution.

The reports are not shared prior to distribution.

9. Local governments adopt annual or biennial budgets and maintain processes for preparing and communicating budget revisions.

The District does adopt an annual budget and maintains a process for developing and communicating the budget.

10. Management may use intranet and internet sites to communicate important information to employees, the governing board, and the public. Information provided on internet sites could include annual financial reports, adopted budgets, and summaries of governing board actions.

The District does use its internet site for the distribution of financial information.

11. Local governments should monitor events at the state and national levels for pertinent legislative or regulatory actions.

The District is a member of the CSDA and monitors alerts and announcements related to changes in state and national legislation and regulations.

12. Meetings of management personnel should be conducted to review governing board agenda items, new initiatives, budget updates, and other important information.

The GM works with all staff and the Board chairs on the agenda, budget and other important issues and communications.

13. Staff meetings provide an opportunity for information sharing up, down, and across the organization.

Staff meetings are ad hoc.

14. Local governments should establish and communicate to their employees a whistleblower hotline to provide a channel for reporting potential wrongdoing. The reporting channel should allow for anonymity and be separate from management's reporting structure to prevent any potential barriers to the reporting of wrongdoing.

There is no whistleblower hotline.

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## **Monitoring Activities**

### **The Objectives of Monitoring:**

The AICPA's Auditing Standard AU-C §315.A.102 defines monitoring as:

*Monitoring of controls is a process that is used by management to assess the effective operation of internal controls over time.*

Monitoring involves evaluating the effectiveness of controls on an on-going basis and taking remedial actions when necessary. On-going monitoring activities often are built into the normal recurring activities of a local government and include regular management and supervisory activities. Management's monitoring of controls includes considering whether they are operating as intended and that they are modified as appropriate for changes in conditions.

Up to now the District has not recognized the setting and monitoring of Internal Controls as a specific area of activity. It does not have specific policies related to monitoring. However, the District has informal practices (see examples 4 through 7) that address the monitoring functions.

### **Examples of Methods That May Be Used by a Local Government to Address Monitoring:**

Below are examples of how a local government might manage its monitoring responsibilities. These are only examples and some local governments might use other methods:

1. When employees are supervised and evaluated by management, local governments should use that process to address issues of internal control that are associated with that employee's duties. This allows management to ascertain the effectiveness of those internal controls over the period that the employee performs his or her duties. As a part of the supervision process, management should communicate management's expectations to the employee with respect to those internal controls. This provides a measure by which management judges the effective operation of those controls.

Internal control duties are not specified in job descriptions.

2. A local government might use periodic meetings with personnel of the finance department to identify issues that affect the quality and timeliness of key controls (monthly cash reconciliations, reconciliations of accounts receivable balances to subsidiary ledgers, updating of capital asset records, etc.). Such meetings might include discussion regarding internal control deficiencies identified by finance department employees in the performance of their duties (such as violations of purchasing requirements by other departments, etc.) and an appropriate response to those deficiencies.

There is no Finance Department, nor is there a regular meeting of those involved in the financial activities to address the issues.

3. Local governments may receive information from on-site reviews of regulatory and funding agencies that comment on the effectiveness of internal controls in certain areas. A local government's monitoring activities may include a consideration of the information provided by these reviews and the development and implementation of actions to correct any deficiencies noted.

This is done on an ad hoc basis.

4. A local government should use its review of budget-to-actual reports to ascertain the on-going quality of the accounting controls that are used to produce reliable and consistent financial information about the local government.

This is currently done.

5. A local government should respond to information received from employees regarding the accuracy of their payroll checks in order to give the local government information about the quality of the internal controls associated with the payroll process.

This is done.

6. A local government should respond to information received from vendors regarding the accuracy of payments made on vendor invoices in order to give the local government information about the quality of the internal controls associated with the accounts payable process.

This is done.

7. A local government should respond to information received from customers regarding the accuracy of utility billings in order to give the local government information about the quality of the internal controls associated with the utility billing system.

This is done.

8. Some local governments may establish audit committees and/or use internal auditors to monitor the on-going effectiveness of internal controls.

This is not done.

9. When a material amount of the local government's transactions are processed by vendors or service organizations, some local governments control the risk of fraud and misstatement associated with those transactions by having a high degree of interaction with the vendor or service organization (e.g., authorizing and reviewing those transactions, etc.) as provided by the AICPA's Auditing Standard AU-C §402.A.7. In other cases, the local government may require that the service organization provide an independent auditor's report on the

effectiveness of the service organization's controls over the processing of those transactions (i.e., a SOC 1 – Type 2 report).

This is not done, but may be too burdensome due to the scale of organizations the District works with.

10. Some local governments include in their monitoring activities a periodic consideration of the continued appropriateness of the organizational structure of the local government to effectively manage the financial reporting risks of the local government.

Up until now, the District has not done this.

11. Some local governments may establish a practical mechanism (e.g. hotline) to permit the anonymous reporting of concerns about fraud or abuse and questionable accounting or auditing practices to the appropriate parties.

The District does not have a reporting process.

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## RECOMMENDATIONS

### POLICIES

#### **Control Environment**

Ethics and Values: Expand current Organizational Ethics and Values policy to include management, staff, and contractors.

Board Oversight: Establish Policy to clearly establish Board Oversight and Board member responsibilities

Internal Communication: Establish policy and procedures to describe Internal Communication processes and activities

#### **Risk Management**

Establish a policy outlining the process for financial monitoring and managing risk.

#### **Control Activities**

Authorization: Establish or redefine job description policies for the segregation of duties, including the role of Board members.

Performance reviews: Establish a policy and procedure for the review financial reports including the budget that includes a monthly review of the current year performance against the prior year.

Information processing: Establish a policy requiring an annual review of the performance of the IT systems of the District that includes hiring a consultant to conduct the review.

Physical controls: Modify the policy for fixed asset accounting to Inventory and specify that maintenance of inventories is the responsibility of the System Operator.

Segregation of duties: Establish policies for duties and assignments that reflect the following-

- 1) Bank reconciliations should be prepared by someone who is not involved in cash receipts or disbursement functions, if at all possible. Also, bank reconciliations

should be reviewed and approved by supervisory level personnel, such as the Board Treasurer who are not involved in daily cash activities.

- 2) Some of the non-technical duties, such as taking deposits to the bank, maintaining check stock, etc, could be performed by administrative staff not involved in cash or accounting functions, possibly even staff from other departments.
- 3) Employees involved in the purchasing function (initiating purchase request, creating purchase orders, approving purchase order) should not be involved in disbursement functions (approving invoices for payment, recording invoices, receiving goods, maintain inventories).
- 4) Receiving cash, deposit preparation and posting deposits to the general ledger should be separated.

### **Information and Communication**

**Information:** Establish a policy that identifies the type and overall performance of the IT systems that support the financial system used by the District.

**Communication:** Establish a policy about the importance of internal communication. This could be made part of the policy relating to ethics and values. Additionally,

- Develop written instructions for the roles of those involved in developing the budget.
- Modify the job descriptions of all personnel to reflect potential financial responsibilities and assignments.

### **Monitoring**

Establish a policy that expands the role for the Finance and budget Committee to include monitoring and assign the GM or consultant the task of developing a financial monitoring plan addressing the performance of internal controls

## **SYSTEM IMPROVEMENTS**

- a. Establish and new Chart of Accounts based on fund accounting
- b. Establish a written set of Bookkeeping procedures
- c. Determine and acquire the best accounting software to address the District's needs

**PERSONNEL**

- Hire an accountant familiar with GAAP or contracting with an independent CPA firm to compile financial statement in conformity with GAAP.
- Hire additional employee to assist in segregating duties, and also provide a review of utility billing and accounting processes to minimize the likelihood of future errors.

**TRAINING**

Provide more training related to internal controls and financial risk management to the General Manager and the Administrative Manager.

Provide training to the Board members about their role and responsibilities for internal Control.

Provide training on semi annually on the use of credit cards.

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Duty	Admin Mgr	GM	Accountant	Office/Ops	Board Member
<b>CASH DEPOSITS</b>					
Collect cash	Green				
Deposit cash into the Banks	Yellow	Green		Green	
Transfer Between accounts	Green	Yellow			Yellow
<b>PAYROLL</b>					
Maintain HR database	Green	Yellow			
Maintain Payroll database	Green	Yellow			
Add employees	Light Green	Green			
Change employee status	Light Green	Green			
Approve Timesheets		Green			Yellow
Disburse Payroll	Green	Yellow			Yellow
<b>DISBURSEMENT/PROCUREMENT</b>					
Maintain Vendor Database	Green	Yellow			
Initiate Purchase Order	Yellow	Green		Green	
Generate Checks	Green				
Review Check Register		Yellow			Yellow
Approve Payment, Sign Checks		Green			Green
<b>REVENUE</b>					
Customer Database	Green	Yellow			
Accounts Receivable Database	Green	Yellow			
Prepare Billing	Green				
Review Billing		Green		Yellow	
Send Billing	Yellow			Green	
Posting Receipts	Yellow			Green	
Approving voided transactions	Green	Yellow			

Duty	Admin Mgr	GM	Accountant	Office/Ops	Board Member
<b>FINANCIAL REPORTING</b>					
Financial reports produced periodically					
Bank Reconciliation					
Subledger Reconciliation					
Financial Transaction Report					
<b>OTHER</b>					
Develop an annual Budget					
Annual Trial Balance or report for Audit					
Monthly Budget Performance					
Research Budget Variances					
Health Reimbursement Arrangement Plan Management/Reporting					
HRA Claim review and approval					
HRA Reimbursement Payment Check					
HRA Payment Signed					