



Internal Controls

July 17, 2024
Aptos, CA



WELCOME!

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Your Instructors Today...

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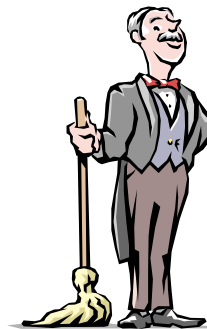
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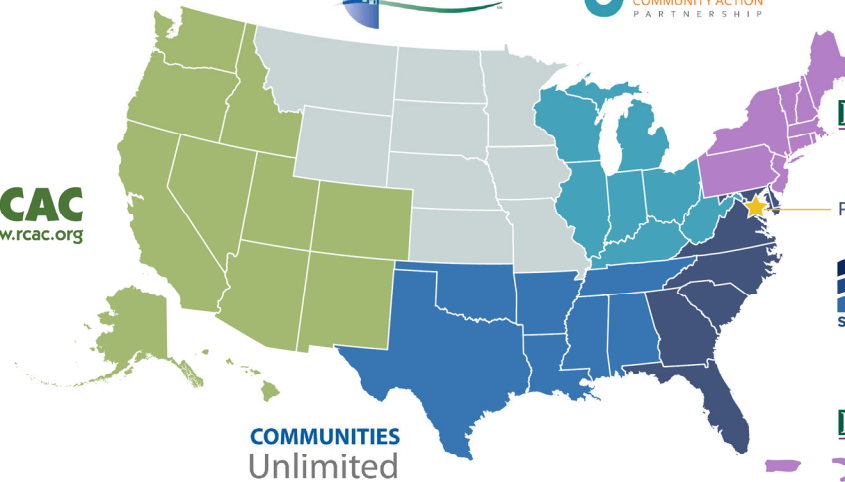
Housekeeping

- Cell phones = set to SILENT
- Participation = encouraged
- Restrooms
- Breaks
- Lunch
- Evaluations
- Certificates will be available for self printing within 10 business days



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RCAP Rural Community Assistance Partnership



RCAP National Office



COMMUNITIES Unlimited

RCAC Programs



Affordable housing



Community facilities



Water and wastewater infrastructure financing (Loan Fund)



Classroom and online training



On-site technical assistance



Median Household Income (MHI) surveys

Performance Assessment Rating Tool (PART)

4 to 6 weeks from today

Email w/ today's workshop in subject line

3 questions – 3 minutes maximum

\$50 Amazon gift card (quarterly)

How did you use the information that was presented today?

Funders are looking for positive change

Help us continue these free workshops!

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Where do I sign up for more trainings?

Visit: <https://bit.ly/RCAC-SWRCB>

Or scan the QR code!



Where is my Contact Hours Certificate?

Evaluations must be completed to receive a certificate.

Certificates for training hours can be downloaded and self-printed **within 10 business days** after the completion of the class.



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Where To Find Answers...

Otto Tang, Water Resource Control Engineer

- Otto.Tang@waterboards.ca.gov
- (916) 319-8579

Division of Drinking Water District offices

- [Division of Drinking Water \(DDW\) District Offices \(ca.gov\)](#)

Your Local Primacy Agency (LPA)

- [Local Primacy Agency Contact Information](#)

SWRCB Drinking Water Program web site:

- [Drinking Water Programs | California State Water Resources Control Board](#)



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Introductions

- Complete Name Tent
- Please tell us about yourself
 - System
 - Position
 - How long you've worked with water systems
 - Your experience/inexperience with internal controls for small water utilities
 - What you hope to learn today

Financial Management Training Series

1. Understanding Financial Statements
2. **Internal Controls**
3. Budgeting
4. Capital Improvement Planning
5. Rate Setting (Online – 5/30/24)
6. Public Meetings and CA. Prop. 218 (Online – 6/09/24)

The Safe Drinking Water Act

Promotes Financial Sustainability Through

Technical
Capacity

Managerial
Capacity

**Financial
Capacity**

Board and Management Responsibilities

Establish framework governing financial management system

Plan for system's financial future

Prepare and adopt annual budget

Monitor/oversight of financial performance

Ensure accountability/integrity of financial system

Internal Control – Today’s Agenda

- Define Internal Control
- Understand Why Internal Control is Vital to a Water Enterprise’s Financial Health
- Review the Four Types of Internal Control
- Identify the Five Key Elements of Internal Control
- Discuss Procedures to Strengthen Internal Control

Exercise #1 - Risks



Review each of the risks identified on the page provided. Working with others at your table, determine why they may be risks. We’ll discuss internal controls intended to mitigate the risks as we progress in this training.

Internal Control



Plan of the organization, methods and procedures, put in place by management to provide reasonable assurance regarding the achievement of its objectives.

Internal Control Objectives



- Safeguard Assets
- Reliable Financial Reporting
- Operational Effectiveness
- Compliance with Applicable Laws & Regulations

What is COSO?

Committee of Sponsoring Organizations

Joint Initiative of Five Private Sector Organizations

Provides guidance on business risk management, internal control and fraud deterrence

What is COSO?

Provides Guidance on:

- Enterprise Risk Management
- Internal Control
- Fraud Deterrence

Principles are applicable to both large and small companies

What is the GAO Green Book?

- Issued by the Governmental Accountability Office
- Standards for internal control for the federal government
- Often adopted by state, local and quasi-governmental entities as well as non-profits
- Standards used in conducting audits
- Mirrors COSO standards (some say)

Four Types of Internal Controls

- Preventative
- Detective
- Corrective
- Compensative

Why is Internal Control important?

Improve Accountability to Stakeholders

Achieve Performance and Budget Targets

Improve Reliability of Financial Reporting

Establish Clear Policies & Procedures for Completion of Tasks

Why is Internal Control important?

Ensure Compliance with Laws & Regulations

Prevent Loss of Resources & Public Assets

Preserve Public Trust

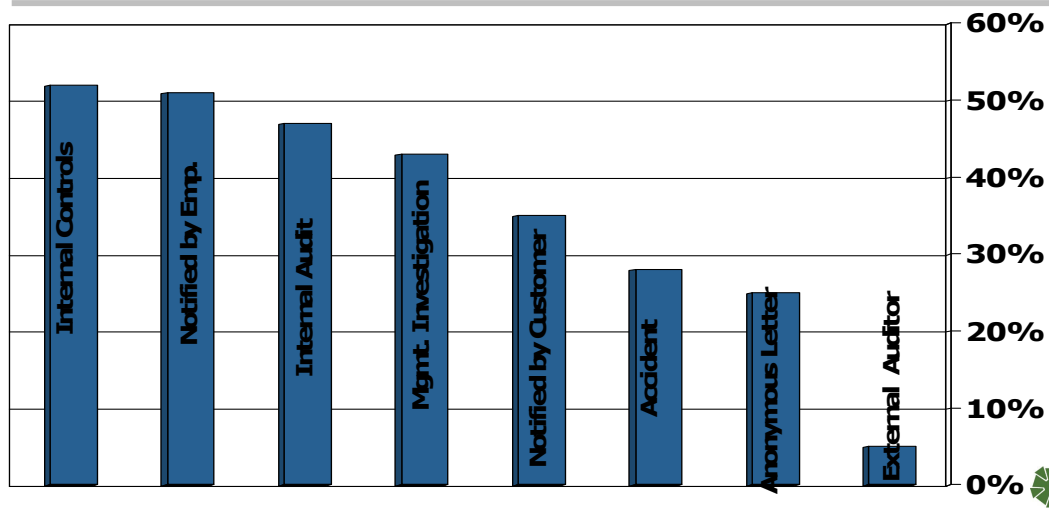
Exercise # 2 – Control Types



From the list of control activities on the worksheet provided, identify the type of each control.

- #1. Preventative
- #2. Detective
- #3. Corrective
- #4. Compensative

How is Fraud Discovered?



Elements of Internal Control



1. Control Environment

- Demonstrates commitment to integrity and ethical values
- Exercises oversight responsibilities
- Establishes structure, authority, and responsibility
- Demonstrates commitment to competence
- Enforces accountability

2. Risk Assessment

Inherent Risk

Control Risk

Residual Risk

Operational Risk

Compliance or Regulatory Risk

3. Control Activities

Separation of Duties

Definition of Responsibilities

Proper Education/Training of Staff

Approval Levels

Bonding of Employees

Documented Procedures

3. Control Activities

Reconciliations

Limit Access to Cash and Assets

Adequate Documentation

Performance Reviews

Observations of Mandatory Vacations/Employee Rotation

External Audits

3. Control Activities - Separation of Duties

No one person has sole control over the lifespan of a transaction.

Ideally, no one person should be able to initiate, record, authorize and reconcile a transaction.

3. Control Activities - Separation of Duties

| Key Concept | Best Practice |
|--|---|
| May vary depending on each utility's size and structure | The level of risk associated with a transaction should come into play when determining the best method. |
| Should be able to be demonstrated to an outside party | Document processes and authorization levels to demonstrate a system of control that includes separation of duties. |
| Should be clearly defined, assigned and documented | Document and clearly communicate who will initiate, submit, process, authorize, review and/or reconcile each activity. |
| Management should increase the review and oversight function when it is difficult to sufficiently separate duties. | Assess the potential for mistakes or fraudulent transactions. If the separation of duties is not sufficient to eliminate or adequately reduce the risk of discovering errors, the level of review of management should be increased over the particular activity. |

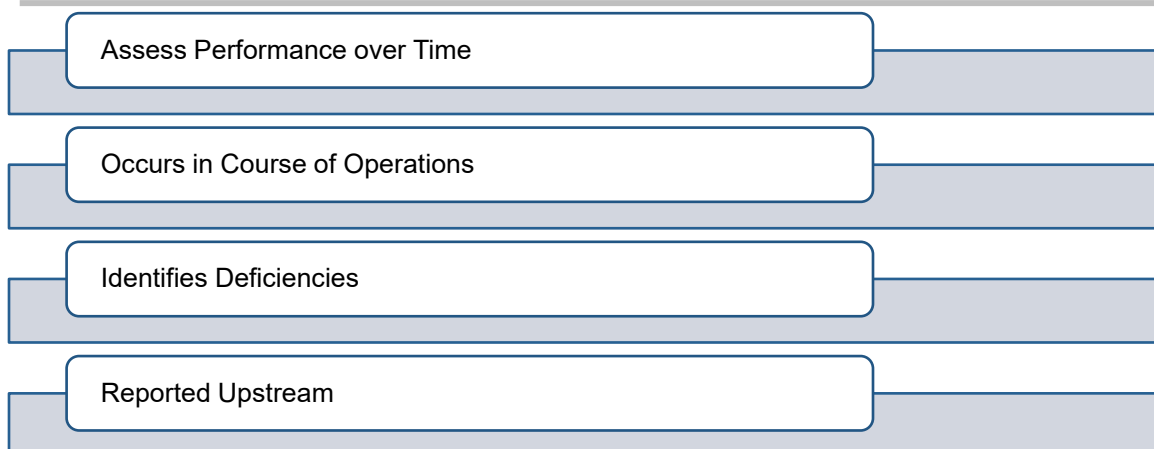
3. Control Activities - Accounting Software Controls

- Individual User Identities
- User Specific Passwords
- Periodic Change of Passwords
- Limited Access to Various Modules of Software
- System Back-Ups at both Onsite and Offsite Locations

4. Information and Communication



5. Monitoring Activities



Exercise #3 - Control Elements



From the list of definitions, identify the control element.

- #1. Control Environment
- #2. Risk Assessment
- #3. Control Activities
- #4. Information & Communication
- #5. Monitoring Activities

What Control Element(s) Would Apply?

First: Is there a problem with this?

Utility gets a good deal on cell phones if they order 6 cell phones. They only need 5 so General Manager takes one home for his daughter to use.

What Control Element(s) Would Apply?

First: Is there a problem with this?

Due to lack of sufficient revenue, governing body votes to discontinue employee retirement fund. The bookkeeper and staff are advised and the utility stops paying the provider.

What Control Element(s) Would Apply?

First: Is there a problem with this?

A detailed budget for the upcoming fiscal year is developed. The governing body approves it. The budget is filed for reference when the next year's budget is prepared.

What Control Element(s) Would Apply?

First: Is there a problem with this?

The bookkeeper enters new vendors in the accounting software, opens mail, enters vendor invoices, cuts checks and mails payments.

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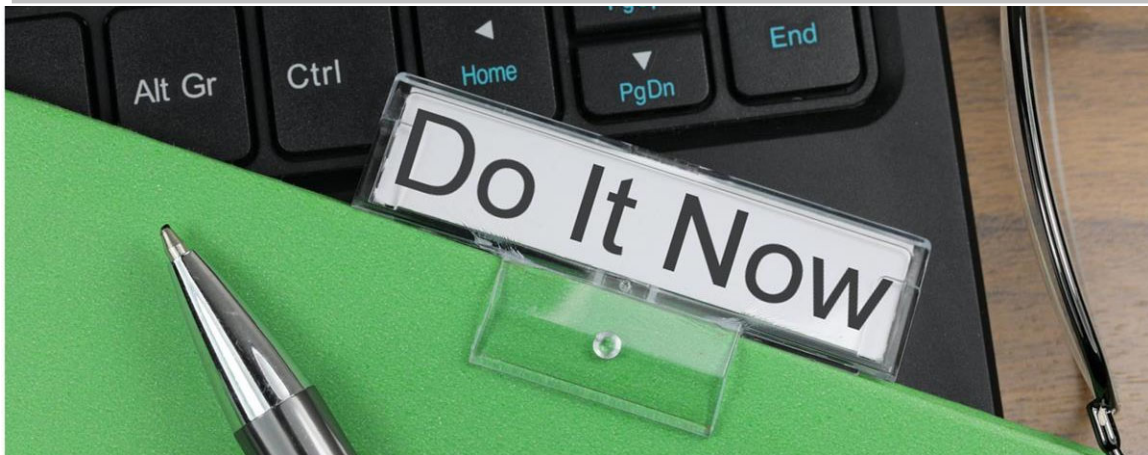
First: Is there a problem with this?

With the focus necessarily on providing clean, safe drinking water and complying with regulations, management and governing body have not had time to review operational practices.

Lunch Time!



Internal Controls in Practice



Physical Assets

- Locks on premises
- Use of Security Cameras
- Employee Access Codes
- Maintain Asset List with Relevant Details of Each Asset
- Perform Regular Asset Audit
- Properly Insure

IT Systems and Data Security

Individual User Identities

User Specific Passwords

Periodic Change of Passwords

Install Firewalls, Anti-Virus Software

Develop Written Policy Guidelines on Personal Use of IT Equipment

Financial Data Integrity

Sequentially Numbered Business Forms

Regularly Perform Reconciliation of Accounts

Develop automated controls such as valid date ranges or dollar-value limits

Implement budget and cash-flow projection reports

Segregate the duties involved in financial transactions

Financial Data Integrity

Institute supervisor-level review of financial records

Build In Validation Checks to Processes

Carry Out Exception Routines

Develop Hierarchy of Spending Level Approval Authority

Rotate duties involved in financial transactions

Financial Data Integrity

Keep sufficient financial record details

Keep books and records up to date and balanced

Ensure employees with financial functions take their annual vacations

Develop a records-retention schedule

Payroll

Maintain security over payroll system passwords and change them regularly

Review bank account deposits to ensure that each pay goes to a different bank account

Separate payroll preparation, disbursement and distribution duties
Check payroll-budgeted figure against payroll-actual figure and invest

Check payroll-budgeted figure against payroll-actual figure and investigate variations

Payroll

Maintain accurate employee attendance records

Maintain complete and accurate payroll records for holiday and sick-leave entitlements and leave used

Use direct bank deposits for pays

Ensure that more than one person can process the payroll

Payroll

Separate the duties of personnel records management and payroll

Develop and document a policy on allowable payroll deductions and who can authorize them

Maintain security over attendance-recording systems

Periodically review the payroll register against actual employees

Water Billings

Develop and document rates schedules

Reconcile Billing Software Register Records with Related General Ledger Account

Have Customer Complaints Handled Independently of the Billing Clerk

Accounts Receivable

Develop Late and Non-Payment Policies

Review the A/R Aging Report Monthly

Reconcile trial balances with general ledger control accounts

Establish Policies/Approval Levels for Credits

Keep the duties involved in accounts receivable separate from cash receipting

Cross Check Customer Credits

Accounts Payable

Develop and document a purchasing and accounts payable procedure, including authorization levels and any price comparison requirements prior to purchase

Pay on original invoices only to avoid duplicate payment

Mark paid invoices to prevent resubmission or double payment

Set payment amount authorization permissions

Accounts Payable

Check invoices from suspect sources e.g. businesses with only a post office box address

Separate the duties of approving new suppliers from responsibility for payment of invoices

Check the record of supplier billing each month and investigate any suspicious activity, i.e., increasing purchases from one vendor

Accounts Payable

Carry out random checks of the invoices of individual suppliers

Investigate invoices for poorly defined services

Develop a process that brings together the purchasing order and receiving reports, along with the check for payment, for review before signature

Handling Cash & Checks

Keep checkbooks in secure storage

Use pre-numbered checks

Endorse checks received "for deposit only"

Enter check disbursements details in a way to prevent easy alteration

Maintain a check register and review checks against it regularly, but at varying (unpredictable) intervals

Handling Cash & Checks

Mutilate voided checks before filing them

Use pre-numbered, triplicate copy cash receipts to keep a record of cash sales

Balance cash daily or more regularly according to the amount of cash handled

Post cash receipts to appropriate journals promptly

Deposit cash receipts regularly to minimize the amount on hand

Handling Cash & Checks

Reconcile bank accounts monthly

Separate duties for cash disbursement and purchases from the approval process

Conduct audits on a varying (unpredictable) schedule and do not warn employees of the date

How could this have been prevented or detected?

Group Discussion

The bookkeeper opens a personal bank account under the name, “Valley Chemicals”. He then creates a “phantom” vendor account in the utility books. Every month he mails an invoice to the utility, writes a check for the invoice and deposits the check in the personal account he opened under Valley Chemicals.

How could this have been prevented or detected?

Group Discussion

The operator is building a new bathroom in her personal residence.

She orders materials through the utility's charge account with a local vendor. The vendor sends a bill to the utility each month and the charges are paid by the bookkeeper (who thinks they are water system repairs) and expensed out as utility water system repairs and maintenance.

How could this have been prevented or detected?

Group Discussion

One of the maintenance staff routinely takes a two-hour lunch break and leaves work an hour early. The payroll clerk does not know this and cuts his paychecks for the full amount he was supposed to have worked, costing the utility thousands of dollars annually.

How could this have been prevented or detected?

Group Discussion

The billing clerk receives cash payments for the water bill. The clerk puts the cash in her pocket and issues a credit to the customer's account for the amount clerk took.

How could this have been prevented or detected?

Group Discussion

The bookkeeper enters time records for payroll, calculates payroll and issues the payroll checks. She feels that she is not adequately paid for her hard work so he/she adds \$500 per month to her paycheck.

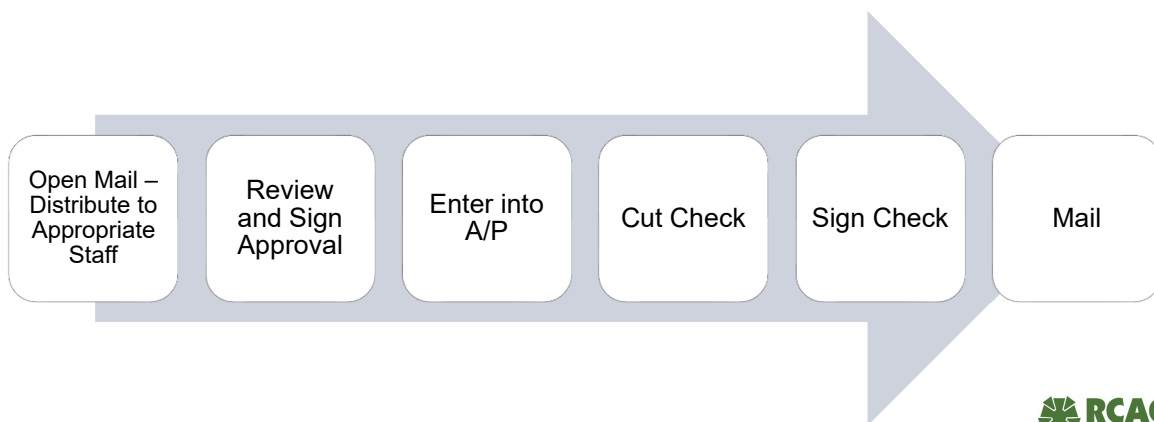
How could this have been prevented or detected?

Group Discussion

The general manager decides to reward her hard-working staff by ordering pizza for lunch to be paid from the petty cash fund. When she asks for the cash from the custodian of the fund, she discovers the petty cash fund is empty and there are no receipts in it to account for where the money went.

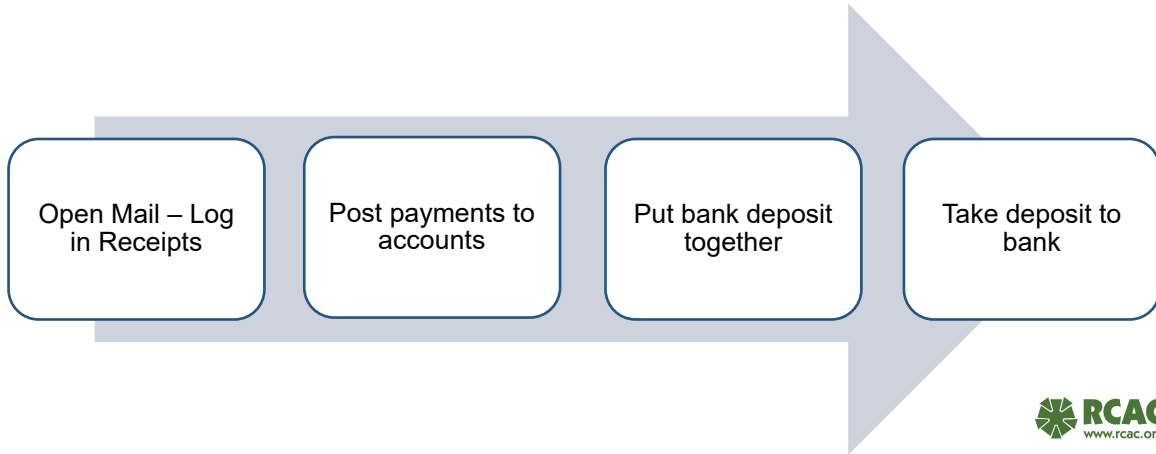
Separation of Duties - Disbursements

When possible, separate the following responsibilities



Separation of Duties - Receipts

When possible, separate the following responsibilities



Exercise #4 – Separation of Duties



Determine how the list of duties can be distributed among employees to implement adequate separation of duties




Financial Policies

Framework for the operation of utility

Must be pertinent to the specific utility

Must comply with:

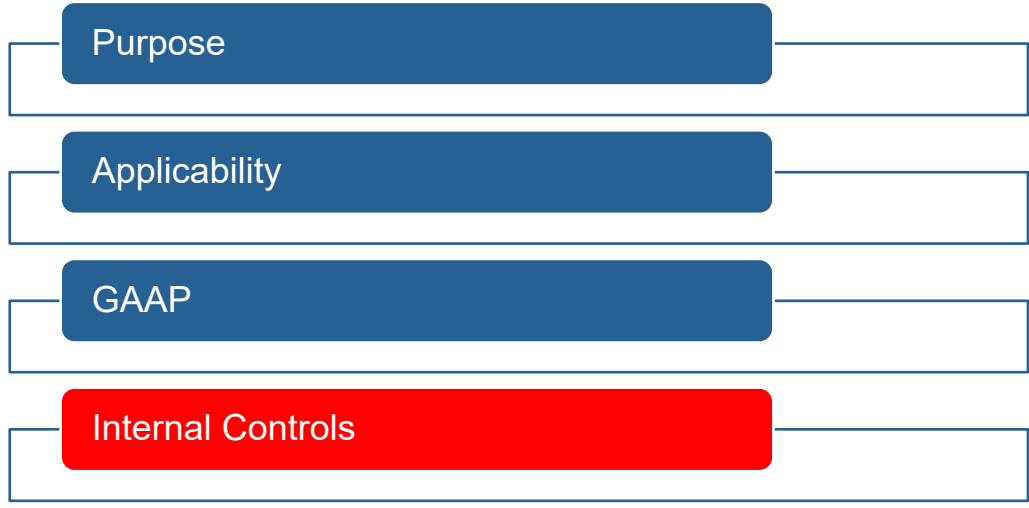
- State Law
- Local Ordinances
- Your system's bylaws or charter
- Loan covenants

 **RCAC**
www.rcac.org



How do we establish policies?

General Financial Policies



General Financial Policies

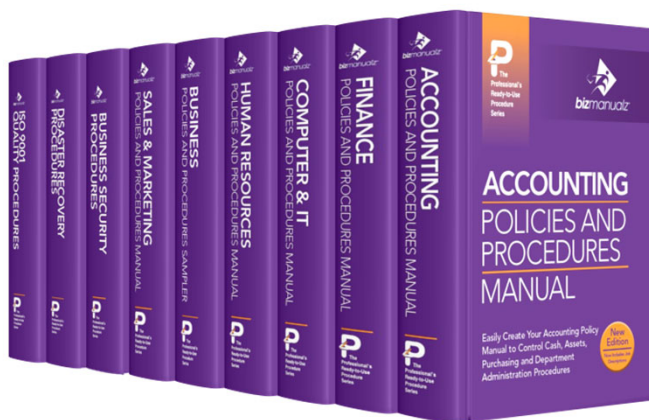
Authorization Levels

Enterprise Accounting

Revenues

Audit

Financial Policies and Procedures Manual



Must Have!!

Banking Policies/Procedures

Establish Circumstances for Opening a New Bank Account

Identify Type of Financial Institution(s) Allowable

Name Who is Authorized to Open a Bank Account

Specify How Many Signatories are Required

Select Who is Authorized to Sign

Determine Where Bank Documents are Kept

Banking Policies/Procedures

Determine Where Unused Checks are Kept

Specify Who has Access to Unused Checks

Develop Procedure for Handling Void Checks

Establish Policy Regarding Issuing Checks Payable to Cash

Establish Policy Regarding Post-Dated Checks

State Who Reconciles Bank Account(s)

Banking Policies/Procedures

Establish Policies Regarding Reserve Funds

Who has Access?

How are Void Checks Handled?

Are Checks Payable to Cash Allowed?

Are Post-Dated Checks Allowed?

Who Reconciles Bank Account(s)?

Banking Policies/Procedures

Separate Bank Account?

Interest Bearing Account?

Reserve Funds

How Often is Cash Transferred
into the Account?

What is Appropriate Use of the
Funds?

Investment Policies & Procedures

Circumstances

Acceptable Financial Institutions

Who Authorizes/Opens Investment Accounts

Who Makes Transfer

Who Reconciles

Petty Cash Fund

Maximum Amount

Allowable Uses

Name Position Managing Fund

Required Documentation for Disbursements

Name Position Reconciling Fund

Difficulties in Implementing Internal Controls in Small Systems

Limited Staff

Significant number of cash transactions

Complex accounting rules

Regulatory focus

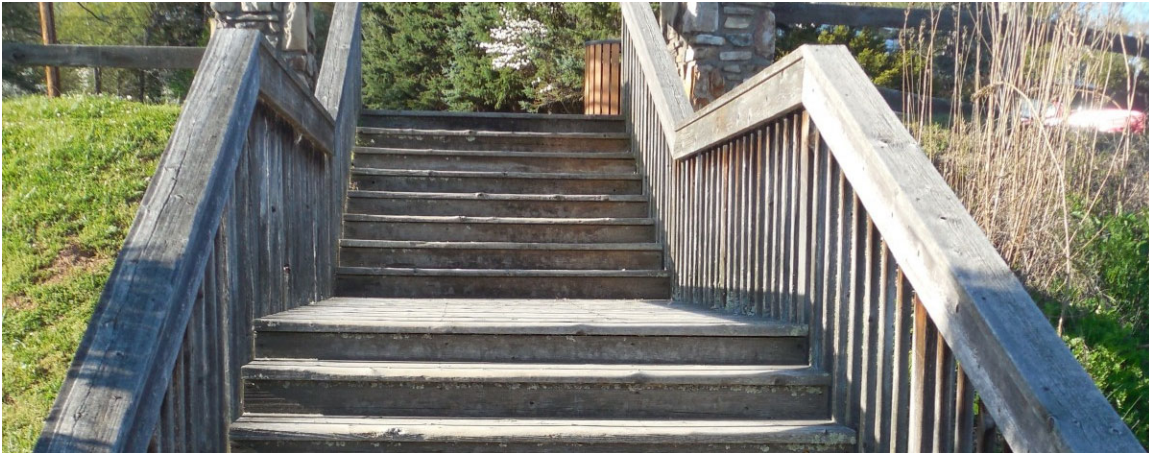
Fewer resources to support accounting function

Exercise #5



How many internal controls issues do you find in the Wobbly Water case study?
What are they?

Steps to Improve Internal Controls



Group Discussion

How can internal controls be implemented in a very small utility?

Steps to Help Utilities Improve Internal Controls

Start where you are!

Make a commitment

Assess Risks

Document procedures and controls

Communicate with staff & train

Continually monitor, evaluate and update

Steps to Improve Internal Controls

Push Up



Internal Controls



Push Down

Other Ways to Protect the Utility

Hire competent staff

Pay staff adequately

Establish, document, follow accounting policies

Insure

Encourage vacations – Have backups trained

When Problems Happen

Have a plan and *make sure everyone knows that you do!*

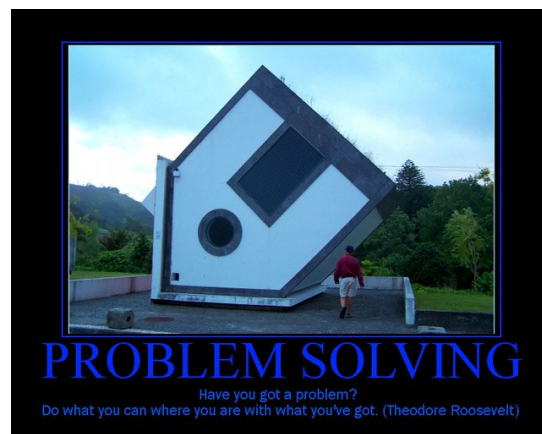
Act quickly and fairly

Document everything

Use outsiders to investigate

Corrective Actions

Find out where the system broke down



Fact or Fiction?

1. A foolproof internal control structure can be devised if management puts forth the effort.
2. Complete, accurate and up-to-date accounting records should be maintained.
3. Broadly speaking, an internal control structure is only necessary in large water companies.
4. Employees should have individual passwords for computer access.

Fact or Fiction?

5. Most fraud is discovered through an external audit.
6. Control environment sets the tone of integrity from the top down.
7. Inherent risk is the level of risk that exists in an activity or process before considering any risk mitigation efforts.
8. Control activities are designed to reduce the opportunity to conceal errors, omissions and fraud.

Fact or Fiction?

9. Shared computer passwords is an acceptable practice because it's easier for shared jobs and/or computers.
10. Direct deposits for employee paychecks is a good internal control practice.
11. The billing clerk should handle customer complaints.
12. Payments to vendors should be made on original invoices.

Fact or Fiction?

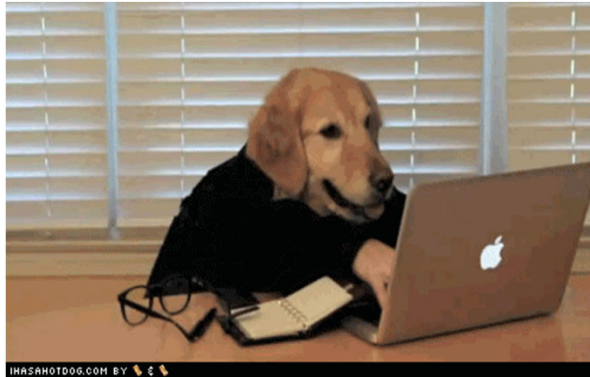
13. The bookkeeper should enter receipts, make payments and reconcile the bank statement.
14. The payroll journal should be approved by someone who does not enter payroll information.
15. Bank accounts should be reconciled quarterly.
16. Random, unpredictable reviews of vendors, customer accounts and petty cash is a good internal control practice.



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Resources and Contacts...

Where do you go to find help?



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https://www.waterboards.ca.gov/drinking_water/programs/



CALIFORNIA

Water Boards

STATE WATER RESOURCES CONTROL BOARD
REGIONAL WATER QUALITY CONTROL BOARDS



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The screenshot shows the California Water Boards website interface. At the top, there is a navigation bar with the CA.GOV logo, social media share icons, and links for About Us, Contact Us, Subscribe, and Settings. Below this is a secondary navigation bar with icons for Board, Programs, Drinking Water, Water Quality, Water Rights, Notices, Water Boards, and Search. The main content area features a grid of links: State Water Resources Control Board, Water Boards Map, Division of Drinking Water, Division of Financial Assistance, Division of Water Quality, Division of Water Rights, and nine regional boards (North Coast, San Francisco Bay, Central Coast, Los Angeles, Central Valley, Lahontan, Colorado River, Santa Ana, San Diego). A 'My Water Quality' link and 'Santa Monica Bay Restoration' link are also present. Below the grid is a 'News' section with a list of recent updates, including notification levels for PFOA and PFOS, testing guidelines, and information regarding water quality in buildings damaged by wildfire. To the right of the news section are two boxes: 'District Offices' with a link to a map, and 'Information for Public Drinking Water Systems' with links to guidance documents, regulations, and law books. The RCAC logo and the number 98 are in the bottom right corner.

Free guide from RCAP

[flip_Financial-Management-Guide.pdf \(rcap.org\)](#)



Resources

University of Washington; Internal Controls

- <https://finance.uw.edu/fr/internal-controls>

Internal Controls: The Definitive Guide for Risk and Compliance Professionals

- <https://reciprocity.com/resource-center/internal-controls-the-definitive-guide-for-risk-and-compliance-professionals/>

UCSF Audit & Advisory Services Internal Controls

- <https://audit.ucsf.edu/internal-controls>

COSO Control Activities

- [COSO – Control Activities \(deloitte.com\)](#)

Resources

American Water Works Association Financial Management for Water Utilities
<https://engage.awwa.org/PersonifyEbusiness/Bookstore/Product-Details/productId/49081979>

Western Municipal Water District
[WMWD Investment Policy](#)

South Coast Water District
[SCWD Investment Policy](#)

US Government Accountability Office
[The Green Book | U.S. GAO](#)

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