



Coachella Valley Water District  
Internal Control Policy

*September 26, 2017*

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## **BACKGROUND**

### **1.1 State Controller's Office (SCO) Internal Control Guidelines**

1. The State Controller's Office, found a lack of internal controls, on a series of SCO audits of local government agencies.
2. Assembly Bill 1248 was sponsored by the SCO and became law on August 28, 2013.
3. California Government Code Section 12422.5 required the State Controller to develop internal control guidelines applicable to each local agency to prevent and detect financial errors and fraud. The guidelines were to be developed based on standards adopted by the American Institute of Certified Public Accountants (AICPA).
4. SCO and the California Society of Certified Public Accountants (CalCPA) took the lead in developing the guidelines with input from many other agencies.
5. The SCO evaluates whether a local government agency has sound internal control policies and procedures sufficient to ensure:
  - a. Accuracy and reliability of the financial data submitted to the SCO; and
  - b. Claims against the state are correct, legal, and in compliance with applicable funding provisions

### **1.2 Internal Control Review by the State Controller's Office**

Evaluation of local government agencies' internal controls based on:

1. Past and current reviews – Assessment of Elements of Internal Control based on the U.S. Government Accountability Office's (GAO) 2001 Internal Control Management and Evaluation Tool.
2. Future reviews – Assessments of Components, Principles, and Attributes of Internal Control based on:
  1. COSO's<sup>1</sup> 2013 Framework
  2. Government Accountability Office's (GAO) 2014 Standards
  3. State Controller's Office (SCO) 2015 Guidelines

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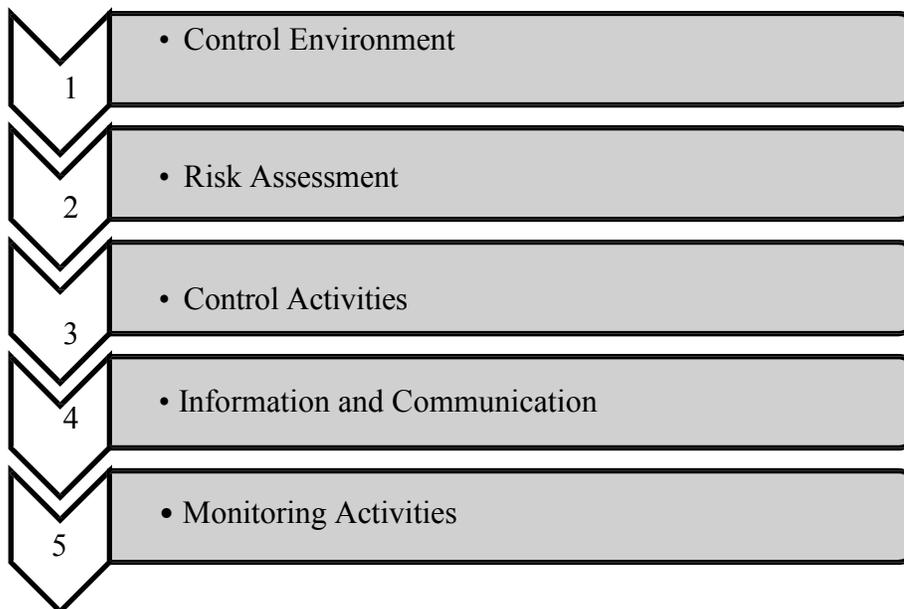
<sup>1</sup> COSO is the Committee of Sponsoring Organizations of the Treadway Commission. COSO is dedicated to providing comprehensive frameworks and guidance on enterprise risk management, internal control, and fraud deterrence designed to improve organizational performance and governance and to reduce the extent of fraud in organizations. COSO is a private-sector initiative jointly sponsored and funded by the following organizations: American Accounting Association, American Institute of Certified Public Accountants, Financial Executives International, The Institute of Management Accountants, and The Institute of Internal Auditors. More information can be found at [www.coso.org](http://www.coso.org).

### 1.3 Internal Control – Why is it so Important?

1. It helps ensure:
  - a. Effectiveness and efficiency of operations;
  - b. Reliability of financial reporting;
  - c. Compliance with applicable laws and regulations; and
  - d. Adequate safeguard of resources.
2. It affects everyone.

### 1.4 Guidelines Were Organized Into the Five Elements of Internal Control (COSO Standards)

The following are COSO's five elements of Internal Control:



### FIVE ELEMENTS OF INTERNAL CONTROL (COSO STANDARDS)

#### 2.1 Control Environment<sup>2</sup> – What Is It?

1. The governance and management functions and the attitudes, awareness, and actions of those charges with governance and management that:
  - a. Sets the tone of the organization.
  - b. Serve as the foundation for all other components of internal control, providing discipline and structure.

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<sup>2</sup> Source: AICPA Auditing Standards AU-C 315.A71

## 2.2 Control Environment - Examples

Any combination of the following:

1. Ethics policy – see Procurement policy.
2. Fraud hotline – **Recommended by the Coachella Valley Water District’s (CVWD) external auditors.**
3. Annual letter or email from the General Manager emphasizing the values of the District and the importance of following policies and procedures.
4. Serious consequences for policy violations, hold staff accountable for their tasks
5. Use of an audit committee.
6. Describe in the “control environment” document how the Board of Directors promotes a strong ethical culture.
7. Human Resources’ use of procedures to ensure that individuals with strong ethical values are hired.
8. Human Resources’ use of training programs to promote best practices.
9. Appropriate follow-up on negative matters noted in staff evaluations and exit interviews.

## 2.3 Risk Assessment<sup>3</sup> – What Is It?

1. CVWD’s identification, analysis, and management of risks relevant to the preparation and fair presentation of financial statements.
  - a. District staff are already performing risk assessment activities without formally documenting the process.
  - b. Acknowledge in the “risk assessment” document how those risk assessment processes are being done.

## 2.4 Risk Assessment Process

1. Identify risks (including unintentional error, fraud, and noncompliance).
2. Estimate the significance of each risk.
3. Assess the likelihood of the occurrence of the error, fraud, or noncompliance associated with the risk.
4. Decide upon the actions to respond to and manage those risks and the results.
5. Use a comprehensive internal control questionnaire to facilitate risk analysis.

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<sup>3</sup> AICPA Auditing Standards AU-C 315.A91

## 2.5 Risk Assessment - Examples

1. Department Head Meetings – Acknowledge in the risk assessment document: The use of weekly department head meetings to receive information from the General Manager (GM). When this information affects the proper recording of transactions, this information is identified and communicated. Explain how this process plays out in CVWD. For example, the GM’s Meeting Notes are shared with all employees.
2. Inventory of Risks – Ask each person in the Finance Department to provide a list of the types of errors that they (or other CVWD departments) might create or the types of fraud that might occur that is associated with their tasks at CVWD.
3. Employee Supervision – Your identification of risks associated with financial reporting might be a bi-product of your employee supervision and performance evaluation process. The “risk assessment” document should describe how information noted during employee supervision and evaluation results in the identification of risks that are evaluated to require further attention. The written description of the process should describe how your agency develops a response to those risks, perhaps giving examples of such responses to assist staff when executing the risk assessment process.
4. Accumulation of Information for Auditors – Throughout the year, management might maintain 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 agency’s independent auditors.

## 2.6 Control Activities<sup>4</sup> – What Are They?

1. “Control activities are the policies and procedures that help ensure that management directives are carried out”
2. Control activities generally include elements of:
  - a. **Authorization** – review and approval.
  - b. **Performance Reviews** – analyzing data by comparing data to expected values based on budgets, forecasts, historical data, etc.
  - c. **Information Processing** – CVWD Information Systems (IS) application controls and IS general controls.
  - d. **Physical Controls** – safeguarding assets.
  - e. **Segregation of Duties** – the persons with functional access to assets (data entry for cash disbursements, etc.) should be different from those that approve the activity and record or reconcile the activity.

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<sup>4</sup> AICPA Auditing Standards AU-C 315.A91

## 2.7 Control Activities – Examples

### 1. Payroll

- a. Only Human Resources (not payroll) has the system access rights to establish or remove an employee from the system.
- b. Someone other than the payroll technician must run a system report that lists all payroll master file changes and compares such changes to properly approved personnel action forms.
- c. The most material payroll frauds involve the creation of fictitious employees (or leaving a separated employee in the system, but then changing the direct deposit bank account to an account that is under the control of the payroll technician).
- d. Simply altering pay rates for selected employees is less likely to produce material amounts of fraud.

### 2. Cash Receipts

- a. Gold standard – Use of cash registers or financial software systems (avoid the use of other “documents” that might satisfy the payer’s expectation for a receipt without the transaction being run through the cash receipts process).
- b. Don’t just focus on currency.
- c. The most material skimming frauds have involved an employee depositing checks made out to the agency into a bank account in the name of the agency that was established by that employee.
- d. An effective control involves two individuals in the Customer Billing Department reconciling the money and payments received to the daily report. Both “reconcilers” review this report and sign this daily reconciliation.

### 3. Control Over Interbank Transfers

- a. During the bank reconciliation, the independent reconciler should trace all interbank transfers to evidence of approval by an authorized initiator and a second approver (other than the initiator).
- b. The reconciler of the bank accounts should not be involved in data entry for cash disbursements, the handling of bank deposits, or the execution of interbank transfers (including investment purchases).

### 4. Debt Management – See separate **Debt Management Policy**

### 5. Procurement / Contract Management / Accounts Payable

- a. Access to the vendor database should be segregated from access to the accounts payable module. CVWD’s Purchasing division has access to add new vendors and Accounts Payables has access to the Accounts Payable module.
- b. Invoices should be checked for mathematical accuracy and approved for payment prior to processing. All invoices for noninventory items are approved for

payment. Invoices for inventory items must have a matching purchase order and proof of receipt, prior to payment.

- c. Check / EFT registers should be reviewed for accuracy by a person independent from the Accounts Payable process and approved prior to finalization. CVWD's Controller reviews each check, or electronic payment, \$10,000 or larger before it is released for payment. One CVWD's Accountants selects a sample of invoices less than \$10,000 for review prior to signing off on the check / EFT registers for checks less than \$10,000. High risk and random payments are selected for review.
- d. CVWD has a very thorough and detailed **Procurement Policy** that includes:
  - i. Standards of Conduct (Ethics)
  - ii. A Procurement Authorization Table – Exhibit A, showing staff's various levels of signing authority
  - iii. Policies regarding when contracts are required
  - iv. Policies regarding when purchases are subject to bidding and informal quotes
  - v. Purchase requisitions
  - vi. Purchase Orders
  - vii. Establishment of Blanket Purchase Orders
- e. The Finance Department runs and reviews monthly internal financial reports, including budget vs. actual summaries. These are distributed to Department Heads and Managers in order to effectively monitor their budgets and expenses. Quarterly budget vs. actuals reports are presented to the Board.

## **2.8 Information and Communication<sup>5</sup> – What Is It?**

1. Information is necessary for CVWD to carryout internal control responsibilities to support the achievement of its objectives.
2. A communication system consists of methods and records established to identify, capture, and exchange useful information.
3. Information is useful when it is timely, sufficiently detailed, and appropriate to the user.

## **2.9 Information and Communication – Examples**

1. Management – authorized job descriptions for all personnel.
2. Policies and procedures to communicate important information about management's expectations for each process.
3. Written ethics policy or code of conduct. (See CVWD's Procurement Policy).

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<sup>5</sup> AICPA Auditing Standards AU-C 315.A84 and 315.A89

4. Communicate management’s message to employees concerning ethics through their daily words and actions.
5. Management should periodically review pertinent policies with key employees.
6. 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.
7. Management should provide written instruction 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.
8. The Finance Department submits quarterly financial reports, as well as a mid-year review, to the Board of Directors for its review.
9. Financial reports prepared for external distribution may be reviewed by management prior to distribution.
10. CVWD adopts annual budgets. The Finance Department maintains processes for preparing and communicating budget revisions.
11. CVWD uses its website extensively to communicate important information to the Board of Directors, the public, and employees.
12. CVWD’s Executive Team meets regularly to discuss Board of Directors’ agenda items, new initiatives, budget updates, and other important information.
13. Staff meetings provide an opportunity for information sharing from Department Heads to their staff. It is important, as well, to share information up, down, and across the organization.

## **2.10 Monitoring<sup>6</sup> – What Is It?**

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

## **2.11 Monitoring Examples**

1. Develop a process of ongoing (daily, weekly, and quarterly) and periodic, programmatic control activities that ensure compliance with laws and regulations.
2. Provide an annual review of the risk assessment process.
3. Ensure corrective action plans are taking place, addressing control deficiencies and respond to the deficiencies in a timely manner.

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<sup>6</sup> AICPA Auditing Standards AU-C 315.A91

4. Use performance evaluations to address issues of internal control that are associated with that employee's duties.
5. Use periodic meetings with personnel of the Finance Department to identify issues that affect the quality and timeliness of key controls.
6. Consider information from on-site reviews of regulatory and funding agencies that comment on the effectiveness of internal controls in certain areas.
7. Use review of budget-to-actual reports to monitor the on-going quality of the accounting controls that are used to produce reliable and consistent financial information.
8. In order to give CVWD information about the quality of the internal controls associated with the following processes:
  - a. Respond to information received from employees regarding the accuracy of their payroll checks.
  - b. Respond to information received from vendors regarding the accuracy of payments made on vendor invoices.
  - c. Respond to information received from customers regarding the accuracy of utility billings.
9. Some local governments may establish audit committees and/or use internal auditors to monitor the on-going effectiveness of internal controls.
10. Maintain a high degree of interaction with vendors or other service providers that process a material amount of the local government's transactions and / or require that the vendor (service organization) provide an independent auditor's report on the effectiveness of the service organization's controls over the processing of the transactions.
11. Establish a hotline to permit anonymous reporting of concerns about fraud or abuse and questionable accounting practices. **Recommended by CVWD's external auditors.**

## 2.12 Compliance

It is the intent of this Internal Control Policy to remain in full compliance with federal, state, local, or other applicable laws or requirements.