

INTERNAL CONTROL MANUAL EXAMPLE

The following Components and Principles are derived from the State of Tennessee Internal Control and Compliance Manual for Governmental Entities and Other Audited Entities in Tennessee – December 2015, which can be found at www.comptroller.tn.gov/la/ICCMaterials.asp

IMPORTANT: How will you show auditors or other's that new internal control procedures are in place and implemented? You cannot just have a written manual. There must be documentation that procedures within that manual have been completed.

COMPONENT 1 – CONTROL ENVIRONMENT

- 1. The oversight body and management should demonstrate a commitment to integrity and ethical values.**

The Board of Directors and the general manager adhere to behavior reflecting integrity and ethical values. They address and identify any conflicts of interest and encourage employees to report any possible conflicts of interest. Upon hiring, an employee is given an employee manual and a code of ethics to be reviewed and signed. Regular meetings with employee's stress ethics, compliance with laws and regulations, and internal control. The General Manager reviews with employees annually the importance of reporting unethical behavior or conflicts of interest.

TO IMPLEMENT THIS: AT THE FIRST BOARD MEETING OF EVERY FISCAL YEAR – THE BOARD REVIEWS THE CONFLICT OF INTEREST POLICY AND CODE OF ETHICS AND DISCUSSES ANY CHANGES OR ISSUES. THIS ANNUAL REVIEW IS DOCUMENTED IN THE BOARD MINUTES. PLEASE NOTE – YOU MAY DISCUSS AT ANY BOARD MEETING, FOR EXAMPLE – YOU HAVE FOUR MEETINGS PER YEAR BUT THE "BIG" BOARD MEETING IS IN DECEMBER WHICH ALL BOARD MEMBERS ATTEND – THIS WOULD BE THE TIME TO DISCUSS AND DOCUMENT ANY CHANGES TO THE CONFLICT OF INTEREST POLICY AND CODE OF ETHICS. YOU WILL NEED TO DO THIS ONCE PER YEAR OR MORE OFTEN IF ANY CHANGES OR INCIDENTS OCCUR.

- 2. The oversight body should oversee the entity's internal control system.**

The Board of Commissioners is responsible for the design, implementation and operation of the Organization's internal control system. The Board of Directors has approved the conflict of interest form, code of ethics, and internal control manual. The Board of Directors reviews the annual outside audit report for any issues with internal control and ensures appropriate action is taken to correct deficiencies.

TO IMPLEMENT THIS: AT THE FIRST BOARD MEETING OF EVERY FISCAL YEAR – THE BOARD REVIEWS CONFLICT OF INTEREST FORM, CODE OF ETHICS, INTERNAL CONTROLS, AND ANNUAL AUDIT. THIS REVIEW IS DOCUMENTED IN THE BOARD MINUTES.

- 3. Management should establish an organization structure, assign responsibility, and delegate to achieve the entity's objectives.**

The General Manager has established an Organization Structure and has documented internal control system by developing a manual to communicate to staff their responsibilities as well as to monitor and evaluate controls. Each employee has a clear job description and any questions regarding that are addressed to the General Manager.

TO IMPLEMENT THIS: THE GENERAL MANAGER, OR DESIGNEE, PREPARES AN ORGANIZATION CHART. AN EXAMPLE IS ATTACHED. THE CHART IS REVIEWED AND INITIALED BY THE GENERAL MANAGER AT THE BEGINNING OF EACH FISCAL YEAR. A WRITTEN JOB DESCRIPTION FOR EACH EMPLOYEE IS DOCUMENTED, UPDATED IF NECESSARY AND REVIEWED AND INITIALED BY THE GENERAL MANAGER AT THE BEGINNING OF EACH FISCAL YEAR.

4. Management should demonstrate a commitment to recruit, develop, and retain competent individuals.

The General Manager is committed to recruiting, developing and retaining competent staff. The General Manger, or designee, reviews and updates the employee manual and encourages continuing professional education.

TO IMPLEMENT THIS: THE GENERAL MANGER REVIEWS THE EMPLOYEE MANUAL AT THE BEGINNING OF EACH FISCAL YEAR, INITIAL AND DATE THE MANUAL AND FILE A COPY WITH THE PERMANENT RECORDS. ANY CHANGES ARE IMPLEMENTED QUICKLY. THE DISTRICT ENCOURAGES OFFICE MANAGERS AND OTHER EMPLOYEES TO ATTEND CONTINUING EDUCATION SEMINARS AND COURSES. THROUGHOUT THE YEAR, THE GENERAL MANAGER, OR DESIGNEE, REVIEWS COURSES AND SEMINARS OFFERED BY TAUD AND OTHER ENTITIES TO DETERMINE THOSE THAT EMPLOYEES WOULD BENEFIT FROM. DURING ANNUAL JOB EVALUATIONS (SEE #5 BELOW), THE GENERAL MANAGER NOTES IN EACH EMPLOYEE FILE, CONTINUING EDUCATION EVENTS ATTENDED AND DISCUSS WITH EMPLOYEES FUTURE TRAINING OPPORTUNITIES.

5. Management should evaluate performance and hold individuals accountable for the internal control responsibilities.

The General Manager conducts periodic job evaluations and enforces a corrective action plan when needed. Segregation of duties checklists are used and reviewed. Employees are held accountable for their duties.

TO IMPLEMENT THIS: THE GENERAL MANAGER AT THE START OF THE YEAR, CONDUCTS JOB EVALUATIONS FOR EACH EMPLOYEE. AREAS OF FOCUS INCLUDE EVALUATING PERFORMANCE THROUGHOUT THE PREVIOUS YEAR, SALARY AND RAISES, FUTURE EXPECTATIONS, JOB DUTIES AND PAST ERRORS/SUCCESSSES.

COMPONENT 2 – RISK ASSESSMENT

1. Management should define objectives clearly to enable the identification of risks and define risk tolerances.

The Board of Commissioners and the General Manager continuously reviewed the Organization's missions and goals. The District has determined a risk threshold of \$5,000 based on oversite structure and the level of materiality the General Manager is comfortable with. Surety bonds and insurance policies are in place to mitigate the risk of loss of funds due to errors, irregularities, or fraud for employees who handle more than \$5,000 annually.

TO IMPLEMENT THIS: THE DISTRICT'S BOARD AND THE GENERAL MANAGER REVIEWS THE MISSIONS AND GOALS OF THE UTILITY AT THE FIRST BOARD MEETING OF THE FISCAL YEAR AND MAKE ANY CHANGES DEEMED NECESSARY. BONDS AND INSURANCE POLICIES AND COVERAGE ARE ALSO REVIEWED. THE LEVEL

OF RISK, IF ACCEPTABLE, IS REVIEWED AND ACCEPTED. THIS MAY CHANGE FROM YEAR TO YEAR. THESE DISCUSSIONS ARE DOCUMENTED IN THE WRITTEN BOARD MINUTES.

2. Management should identify, analyze, and respond to risks related to achieving the defined objectives.

The General Manager has identified risks within the District. The operation objectives include – ensuring that the entity’s resources are adequately safeguarded; provided services efficiently and effectively; provide for the long-term stability of the District; and provide a stable and rewarding work environment for employees. Financial reports, schedules, cash balances, and budgetary comparisons (prepared by someone in finance or the outside accountants) are reviewed monthly with the General Manager and Board of Commissioners. Accounting functions are handled by different individuals as outlined in the segregation of duties worksheet. Any areas of concerns are addressed and a plan of action is discussed. State statutes require an annual audit being performed in accordance with generally accepted government auditing standards and requirements of Tennessee Comptroller of the Treasury and grant requirements. Attendance by district employees of any training programs related to compliance with all relevant laws, regulations, contracts and grant agreements are documented.

3. Management should consider the potential for fraud when identifying, analyzing, and responding to risks.

The General Manager and other staff attend training sessions and meetings to identify types of fraud that can occur. The General Manager documents these areas as well as “safeguards” to counter fraud.

THE FOLLOWING ARE A FEW EXAMPLES OF RISKS AND RESPONSES THAT A UTILITY MAY OR MAY NOT HAVE:

Risk: Cash could be stolen **Response:** Separate cash drawers will be used for each employee which only they have access to. Cash will be reconciled at the end of each day to the daily cash report and reviewed by the General Manager or designee.

Risk: Payroll could be mishandled. **Response:** All time sheets are reviewed and initialed by the General Manager, or designee. After entering the information into the accounting system, the payroll clerk goes online and enters direct deposit information for each employee. The accounting system and online direct deposit system is password protected and the password is changed quarterly. The clerk prints out a payroll summary detailing employee’s gross earnings and direct deposit amount. This printout is given to the General Manager, or designee, to review for errors and sign off on. At the end of each month the total direct deposit amount is reconciled to the bank statements in order to make sure these amounts match.

Risk: Expenditures could be reported fraudulently **Response:** When bills come in the mail, they are reviewed and payment authorized by the General Manager, or designee, by initialing and dating each bill. Segregation of duties worksheet details who handles each function. All checks are reviewed and signed by two parties as designated by the Board of Commissioners. A third individual is designated to sign checks in situations where one of the two authorized check signers is unavailable. The Utility District should NOT have a signature stamp.

Risk: *Fraudulent financial reporting* **Response:** *Bank accounts are reconciled monthly within 30 days or receipt of the bank statement and all outstanding items reviewed. Accounts receivables and accounts payable are reviewed monthly for accuracy. Financial statements are reviewed monthly by the General Manager and the Board of Commissioners.*

4. Management should identify, analyze, and respond to significant changes that could impact the internal control system.

The General Manager keeps up to date with accounting changes, employee laws and other business practices by attending continuing education training sessions which address such matters and meet with legal counsel regularly. Any significant changes are identified and implemented if needed.

THE FOLLOWING IS AN EXAMPLE OF RISK AND RESPONSE THAT YOUR UTILITY MAY OR MAY NOT HAVE:

Risk: *The Utility District is awarded new grants during most fiscal years. Reporting requirements may not be met.* **Response:** *During the planning process, the General Manager identifies controls and determines if procedures need to be adapted. All grant awards are thoroughly reviewed by the General Manager to determine purpose of grant, reporting requirements, and expenditures allowed. Grants agreements are reviewed thoroughly and signed copies are kept in files. Reporting requirement deadlines are documented. After filing such reports, the individual responsible for such provides documentation to the General Manger that all reports have been filed.*

Risk: *During the year, overtime laws changed that affect employees at your District.* **Response:** *The General Manager is systematically updated to any changes in employment law. This can be accomplished by attending training sessions once a year that focus on employee issues/laws and subscribing to newsletters from various Organizations or going to the State of Tennessee website at <https://www.tn.gov/workforce/section/labor-laws> and reviewing labor laws every few months. The General Manager, or designee, should document in writing (by initialing and dating) that the review was performed, training session attended, or a copy of newsletter reviewed.*

COMPONENT 3 – CONTROL ACTIVITIES

1. Management should design control activities in order to achieve objectives and respond to risks.

The General Manager has developed a segregation of duties worksheet detailing out employee functions within the Utility.

TO IMPLEMENT THIS: ATTACHED IS AN EXAMPLE OF A PROPER SEGREGATION OF DUTIES WORKSHEET FOR AN OFFICE WITH FOUR EMPLOYEES, YOUR UTILITY MAY HAVE A DIFFERENT AMOUNT OF EMPLOYEES AND WILL NEED TO DEVELOP COMPENSATING CONTROLS. EACH EMPLOYEE IS PROVIDED A COPY OF THE WORKSHEET. IT IS STRESSED THAT THEY SHOULD MAINTAIN THE PROPER SEGREGATION OF DUTIES IN CARRYING OUT INDIVIDUAL JOB RESPONSIBILITIES. THE GENERAL MANAGER, OR DESIGNEE, CONFIRMS THAT EMPLOYEES ARE MAINTAINING A PROPER SEGREGATION OF DUTIES BY OBSERVING OPERATIONS AT LEAST ONCE A MONTH OR AS OFTEN AS NECESSARY.

2. Management should design the entity’s computerized information system and related control activities to achieve objectives and respond to risks.

The software used by the Utility is updated as needed and each employee has password controls. Employees are “blocked” from all functions within the system that they do not require access to in order to carry out their responsibilities. All computers are updated regularly and virus protection is installed. All data is backed up every night on an external drive which is stored at a secured offsite location.

TO IMPLEMENT THIS: AN OUTSIDE INDEPENDENT COMPUTER COMPANY IS HIRED EVERY QUARTER TO CHANGE LOG IN PASSWORDS, ACCOUNTING PASSWORDS, SOFTWARE PASSWORDS AND UPDATE VARIOUS SOFTWARE PROGRAMS. AT THE INITIAL SET UP – THE COMPUTER COMPANY ENSURES THAT EMPLOYEES DO NOT HAVE ACCESS TO FUNCTIONS WHICH ARE NOT NECESSARY FOR THEM TO CARY OUT THEIR DUTIES.

3. Management should implement control activities through policies.

The General Manager, or designee, reviews and updates the employee manual, segregation of duties worksheet and other manuals as needed. All policies are documented and signed.

TO IMPLEMENT THIS: AT THE START OF THE FISCAL YEAR, THE GENERAL MANAGER, OR DESIGNEE, REVIEWS ALL DISTRICT POLICIES AND UPDATES THEM AS NEEDED. AFTER THE REVIEW, THE GENERAL MANAGER INITIALS AND DATES EACH POLICY FOR THE FILES.

COMPONENT 4 – INFORMATION AND COMMUNICATION

1. Management should use quality information to achieve the entity’s objectives.

The General Manger, or designee, reviews and evaluates on a regular basis, whether quality information is used to make informed decisions and if objectives are being achieved.

THE FOLLOWING ARE A FEW EXAMPLES OF RISKS AND RESPONSES THAT A UTILITY MAY OR MAY NOT HAVE:

Risk: *Monthly Financial statements given to the Board of Commissioners may not be reliable.*

Response: *The Utility District’s Accountant has 15 years’ experience and attends continuing education sessions. The General Manger, or designee, ensures that monthly bank accounts are reconciled on a timely basis, reviews accounts receivable and accounts payable, general ledger activities, journal entries, and net asset restrictions. The financial statements are audited each year by an Independent CPA firm and suggestions/findings are made and implemented as needed.*

Risk: *The Utility District may not provide quality and reliable services to its customers.*

Response: *The General Manager, or designee, addresses and responds to customer complaints in a timely manner. The General Manager, or designee, evaluates the current and future needs for Infrastructure and equipment to determine best interests of customers during meetings with the Board of Commissioners, Engineers and others.*

2. Management should internally communicate the necessary quality information to achieve the entity’s objectives.

Routine staff meetings are held to discuss policies, procedures, projects and other Utility business. The General Manager makes it a priority for all employees to have a voice. There should be a level of confidentiality between employer and employee. Human resource issues need to be addressed and solutions implemented by standard policies in place.

TO IMPLEMENT THIS: THE GENERAL MANAGER DETERMINES THE FREQUENCY OF STAFF MEETINGS NEEDED. MEETINGS COULD BE HELD WEEKLY, TWICE A MONTH, MONTHLY, QUARTERLY OR ANNUALLY. EACH EMPLOYEE IS ASKED FOR A LISTING OF PROJECTS THEY ARE WORKING ON AND ANY ISSUES THEY WOULD LIKE TO DISCUSS. THE GENERAL MANAGER, OR DESIGNEE, DOCUMENTS THE MEETING AND WHAT WAS DISCUSSED, INITIALING AND DATING THE DISCUSSION FOR THE FILE.

3. Management should externally communicate the necessary quality information to achieve the entity's objectives.

Communications with outside parties are generally handled by the General Manager, or designee. This may involve the public, auditors, grant agencies, vendors, insurance companies, law enforcement officials, news media, attorneys, public interest groups.

THE FOLLOWING ARE A FEW EXAMPLES OF RISKS AND RESPONSES THAT A UTILITY MAY OR MAY NOT HAVE:

Risk: *The local newspaper requests annual salaries for all government employees. There could be restricted information provided to the newspaper.* **Response:** *The General Manager, or designee, evaluates the need and legal requirements to provide the requested information. After discussions with an attorney, it is determined that this information is public record. The General Manager, or designee, ensures the listing of wages does not provide personal information such as social security numbers, date of birth, or addresses of employees.*

Risk: *Your grantor agency calls and wants a copy of your monthly financial statement and bank statements.* **Response:** *The employee that takes the call directly refers the call to the general manager. The General manager, after reviewing grant contract, decides that this is standard practice and a requirement under the grant award and sends this information to grantor agency by email. This email is kept with the grant file for documentation.*

COMPONENT 5 – MONITORING

1. Management should establish and operate monitoring activities to monitor the internal control system and evaluate the results.

The Board of Commissioners, the General Manger and other appropriate district personnel, regularly meet and discuss issues related to internal control including current condition, changes needed, differences in processes. Such discussions are documented in the Board meeting minutes.

TO IMPLEMENT THIS: ON THE FIRST BOARD MEETING OF THE FISCAL YEAR, THE GENERAL MANAGER AND BOARD MEMBERS DISCUSS AND REVIEW INTERNAL CONTROL POLICIES AND DOCUMENT SUCH DISCUSSIONS IN BOARD MINUTES.

2. Management should remediate identified internal control deficiencies on a timely basis.

The General Manager documents all reported internal control issues and deficiencies and audit findings and evaluates each issue for corrective action.

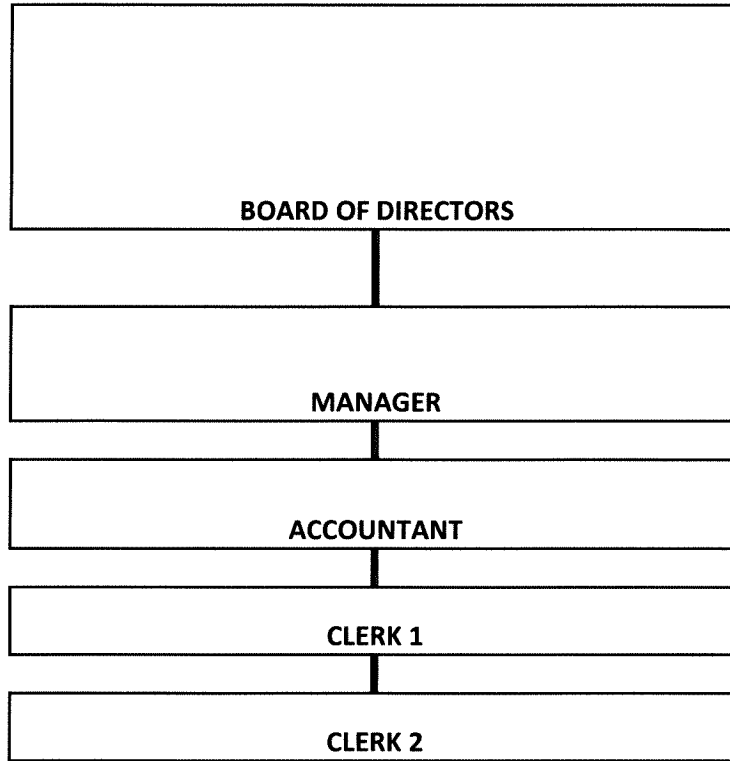
FOR EXAMPLE: THE ANNUAL AUDIT INDICATES AN AUDIT FINDING RELATED TO SEGREGATION OF DUTIES. THE DISTRICT IS A TWO PERSON OFFICE CONSISTING OF A GENERAL MANAGER AND CLERK, AND CAN NOT AFFORD TO HIRE ADDITIONAL STAFF. THE GENERAL MANAGER EVALUATES THE PROCEDURES AND

DETERMINES THAT A BOARD MEMBER COULD COME IN TWICE A MONTH AND SIGN CHECKS AND REVIEW ALL INVOICES. THE GENERAL MANAGER ALSO NOTICES THAT CUSTOMER PAYMENTS ARE RECEIVED, DEPOSITS TAKEN TO BANK AND BANK RECONCILIATIONS ARE ALL PERFORMED BY CLERK. THE GENERAL MANGER DECIDES TO OPEN, REVIEW AND INITIAL ALL BANK STATEMENTS AND TAKE ALL DEPOSITS TO BANK.

Governing Boards are required by law to be responsible for internal control. These are guidelines that can be incorporated and adapted into your own individual internal control manual in order to be compliance with the law. This working document is devised in part from the State of Tennessee Internal Control and Compliance Manual for Governmental Entities and Other Audited Entities in Tennessee – December 2015, which can be found at www.comptroller.tn.gov/la/ICCMaterials.asp

**DISTRICT
ORGANIZATION STRUCTURE**

The example has four employees that report to the Board -



UTILITY DISTRICT
SEGREGATION OF DUTIES

THIS EXAMPLE IS FOR 4 PERSON OFFICE:

The following financial related tasks are assigned to each employee:

<u>Accountant</u>	<u>Clerk 1</u>	<u>Clerk 2</u>	<u>General Manager</u>
Record A/R entries	Receive cash	Process payroll	Signs checks
Reconcile petty cash	Opens mail except for bank statements.	Process vendor payments	Approves payroll
Write checks	Processes cut off notices	Takes deposits to bank	Approves vendor payments
Record journal entries		Invoices customers	Reviews bank statements
Reconcile bank statements			Reviews petty cash receipts
Prepares financial statements			Reviews financial statements
Reconciles credit cards			Reviews deposits
			Reviews credit cards
			Approve journal entries

Expanded Duties include:

Utility Billing and Collection

	<u>Accountant</u>	<u>Clerk 1</u>	<u>Clerk 2</u>	<u>General Manager</u>
Maintain customer account information		X		
Process utility orders			X	
Received utility deposits		X		
Run billing			X	
Receive customer payments		X		
Print and mail bills			X	
Post utility activity to general ledger	X			
Balance cash drawer	X			
Make daily deposits			X	
Process late/cut off notices		X		
Approve account adjustments				X
Enter account adjustments in system	X			
Print daily and monthly reports	X			
Review daily and monthly reports				X
Reconcile A/R for accuracy	X			

**General
Manager**

Clerk 2

Clerk 1

Accountant

Expanded Duties include:

Payroll Processing

Maintain employee information on computer				X	
Enter time sheets					
Review time sheets		X			
Approve leave requests					X
Distribute payroll stubs in sealed envelopes					
Process direct deposits				X	
Process payroll				X	
Review direct deposit report					X
Make payroll tax deposits				X	
Prepare federal and state payroll returns				X	
Prepare W-2's for calendar year				X	
Maintain payroll reports				X	
Review payroll registers					X

Purchasing and Payment

Receive requests for purchases				X	
Ensure budget appropriation is available					X
Approve purchases					X
Enter invoice / post to general ledger					
Prepare checks				X	
Sign checks					X
Prepare 1099's for calendar year					
Maintain purchase documents/ invoice				X	
Review account postings					X

Expanded Duties include:

**General
Manager**

Clerk 2

Clerk 1

Accountant

Credit Cards

Open mail				X		
Review credit card charges		X				
Approve credit card charges						X
Code expenditures on statement		X				
Post to general ledger		X				
Maintain all credit card receipts		X				
Maintains credit cards in locked drawer						X

General Ledger Activities

Prepare journal entries		X				
Approve journal entries						X
Reconcile bank statements		X				
Post journal entries		X				
Open and review bank statements						X
Prepare financial statements		X				
Review financial statements						X