



# Internal Controls

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# Internal Controls are defined as

- a process designed to provide reasonable assurance about the achievements of an entity's:
  - 1) objectives with regard to the reliability of financial reporting,
  - 2) effectiveness and efficiency of operations, and
  - 3) compliance with applicable laws and regulations.

# Internal Controls are:

- Procedures adopted to:
  - Safeguard assets
  - Check the accuracy and reliability of accounting data
  - Promote operational efficiency
  - Encourage adherence to managerial policies



# Procedures To Minimize Control Weaknesses

- No one person handle all aspects of a financial transaction. Segregation of duties makes it more difficult for theft and errors to go undetected. More than one employee is needed to accomplish segregation of duties.



# Control Cash Receipts

- Have someone other than bookkeeper open mail and list all cash receipts
- Have all checks endorsed “for deposit only” with a company stamp when mail is opened
- Keep cash handling and recordkeeping separate



# Control Cash Receipts (continued)

- Compare listing of cash receipts with the cash receipts journal and deposit slips
- Deposit cash receipts daily
- Post cash receipts to accounts receivable ledgers promptly



# Control Cash Disbursements

- Make all disbursements by check (other than petty cash)
- Prohibit checks payable to cash
- Make sure all checks are prenumbered and accounted for
- Require adequate documentation before signing checks
- Never sign blank checks



# Control Cash Disbursements (continued)

- Prepare monthly bank reconciliations
- Person preparing bank reconciliation should be different than one handling cash
- Chairman or secretary should receive unopened bank statements and review prior to submitting to utility
- Keep blank checks locked up



# Simple Example for Small Utility



# Segregation of Duties for Money Received

- Person 1 - receives money (mail and walk-in) and records who payment was from, what it was for, and whether cash or check.
- Person 2 - gets money and list from person 1, makes sure money and list match, prepares deposit slip and takes it to the bank.



# Segregation of Duties for Money Received

- Person 3 - records the money into the accounting system and verifies that deposit matches payment information
- Person 4 - receives the bank statement and prepares reconciliation, matching bank deposits actually made with what was supposed to have been made.



# Segregation of Duties for Money Spent

- Person 1 - purchases/orders items needed to operate and maintain the system (the person that spends the money)
- Person 2 - writes the check, making sure funds are available and invoice approval procedures have been followed.



# Segregation of Duties for Money Spent

- Person 3 - signs the checks, double-checking to be sure money is available and that disbursement approval procedures have been followed.
- Person 4 - receives the bank statement and prepares reconciliation, checking signatures and comparing statement with information in accounting system.



# Other Internal Controls

- Prescreen employee applicants, thorough background checks
- Educate employees
- Make sure employees take regular vacations
- Rotate job duties occasionally



# Other Internal Controls

- Give employees a way to report fraud
- Provide active oversight
- Have a written code of ethics
- Obtain fidelity bonding, governed by KRS 65.067 for water districts which requires that the bond amount be based on the maximum amount of public funds the individual handles at any given time during a fiscal year cycle. Amount of bond left up to Commissioners?



# Office Procedure Manual

- Document recordkeeping procedures for handling receipts, processing invoices, etc.
- Document procedures such as processing applications for service, discontinuance of service, disconnection procedures, etc.



# Personnel Issues

- Develop job descriptions, get help from CPA to develop proper segregation of duties.
- Conduct annual performance evaluations
- Maintain employee handbook



# Oversight - Things to Review During Monthly Meetings

- Receipts and disbursements for the preceding period
- Monthly bank reconciliation for each account
- Aged accounts receivable listing
- Adjustments to customers' accounts
- Cash disbursement pre-approval documents should be reconciled with each entry to the cash disbursement journal, KRS 74.050



# More Things to Review Each Month

- Uncollectible accounts to be written off as bad debts. For an annual period, a water utility's bad debts when using the allowance method should be between .5 to 1 percent of retail water sales revenue if employing effective customer deposit and shut-off policies.
- Gallons of water purchased/produced and gallons of water sold
- Manager's expenses
- Unpaid invoices to approve for payment
- Compare monthly budget to actual



# Annual Oversight Tasks

- Conduct annual performance evaluation of general manager
- Prepare budget.
- Meet with external auditors prior to start of audit and after audit report is prepared



# Annual Oversight Tasks

- Review year-end financial statements including audit and annual report
- Evaluate financial position and consider whether any changes are required



# Internal Control Limitations

- System design - No such thing as a perfect control system
- Implementation - Human error, misunderstandings, fatigue and stress
- Things change - Need to re-evaluate procedures periodically



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