

LAMONT PUBLIC UTILITY DISTRICT

Review Report

ADMINISTRATIVE AND INTERNAL ACCOUNTING CONTROLS

July 1, 2012, through June 30, 2014



BETTY T. YEE
California State Controller

July 2016



BETTY T. YEE
California State Controller

July 29, 2016

Jose G. Cruz, President
Board of Directors
Lamont Public Utility District
8624 Segrue Road
Lamont, CA 93241

Dear Mr. Cruz:

Enclosed is the report of the State Controller's Office (SCO) review of the Lamont Public Utility District's administrative and internal accounting controls. The review was conducted to assess the adequacy of the district's controls for safeguarding assets and to ensure proper use of public funds.

Our review found weaknesses in the district's accounting and administrative controls system. We also noted the numerous deficiencies described in the Findings and Recommendations section of our report.

As a part of the review, we assessed various aspects of the district's internal control components and elements based on guidance by the Government Accountability Office. Of the 79 control elements evaluated pertaining to internal control components, we found 65, or 82% that were considered inadequate and one control element that was not applicable.

The results of our review and evaluation of the elements of internal control are included in this report as an Appendix. Our assessments of the elements were based on the conditions that existed during our review period of fiscal year (FY) 2012-13 and FY 2013-14.

It should be noted that the district is in the process of developing corrective actions and implementing our recommendations. Therefore, the district should be commended for taking these matters seriously and being proactive in resolving the noted deficiencies. We would like to express our thanks to the district staff and management, who were helpful throughout the review process.

As always, my staff and I are available to address your questions. You may contact Christopher Lek, Interim Chief, Local Government Audits Bureau, by telephone at (916) 284-0120, or by email at clek@sco.ca.gov.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/lis

cc: Martin Nichols, Interim General Manager
Lamont Public Utility District

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Appendix—Evaluation of Elements of Internal Control

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Review Report

Introduction

The State Controller's Office (SCO) reviewed the Lamont Public Utility District's system of administrative and internal accounting controls for the period of July 1, 2012, through June 30, 2014 (fiscal year [FY] 2012-13 and FY 2013-14). We expanded our testing as necessary to include current and/or prior-period transactions to follow up on issues identified through our interviews of district officials and through our review of the independent auditors' reports and other audit reports.

On January 14, 2016, the SCO notified Nicholas Turner, then District Manager, that the district did not comply with state law regarding the submittal of annual reports and independent audits. In our analysis and comparison of Financial Transactions Reports to the audited financial statements, we noted differences as follows:

Financial Transactions Reports

- Discrepancies found between the Financial Transactions Reports and the Audited Financial Statements
- Ongoing operating deficits in the Waste Disposal Enterprise Fund; 30% in FY 2012-13 and 13% in FY 2013-14

Independent Auditor's Reports (FY 2012-13 and FY 2013-14)

- Findings noted in the Independent Auditor's Reports such as:
 - No reconciliation of payments received and posted against customer accounts
 - No controls over collected cash and checks on a daily basis with the amount of cash and checks deposited with the bank
 - No controls over the journal entry process
 - No recording of expenses for capital assets
 - No reconciliation of cash accounts on a monthly basis

Government Compensation Reports

- Government Compensation Reports were submitted late for calendar years 2010 through 2013.

After considering the above information, the SCO has concluded that there is reason to believe that the district's ability to provide reliable and accurate information relating to required financial reports is questionable. Therefore, under Government Code section 12464(a), we conducted an investigation to validate the Financial Transactions Reports submitted by the district for FY 2012-13 and FY 2013-14. Under Government Code section 12464(b), the costs of this review, including those for preparing a report of the results and transmitting copies to the Board of Directors, will be borne by the district.

Our review included an analysis of the district's administrative and internal accounting controls and fiscal management practices. This included assessing the impact of allegations of wrongdoing by district officials and any findings on selected local, state, and federal programs administered by the district.

This report presents the results of findings and conclusions reached in our review of the district's administrative and internal accounting controls system.

Background

The Lamont Public Utility District is a water and sewer agency formed in 1943 pursuant to the California Public Utility District Act (California Public Utilities Code §15701 et seq.), with the purpose of providing water and sewer service to residential, municipal, commercial, and industrial developments within its boundaries. The district is governed by a five-member Board of Directors, elected for four-year terms. The district has a population of approximately 18,290.

The district is located in the southern end of the San Joaquin Valley in Kern County, California, approximately ten miles south-southwest of the City of Bakersfield. It currently consists of a single service area, wastewater treatment plant, and effluent use areas.

The district's service area encompasses the communities of Lamont and Weedpatch, and undeveloped land in the immediate vicinity. Within its service area, the district provides its customers with water and sewer services. It also serves as an intermediary between residents and Pacific Gas & Electric Company for concerns related to the operation, installation, and maintenance of street lighting. The district does not actually operate or maintain lighting facilities.

Objectives, Scope, and Methodology

Our review objective was to evaluate the district's system of administrative and internal accounting controls to ensure:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations
- Adequate safeguarding of public resources

To accomplish our objective, we performed the following procedures:

- Evaluated the district's formal written internal policies and procedures
- Conducted interviews with district employees and observed the district's business operations for the purpose of evaluating district-wide administrative and internal accounting controls
- Reviewed the district's documentation and supporting financial records

- On a limited basis, performed tests of transactions to ensure adherence with prescribed policies and procedures and to validate and test the effectiveness of controls
- Assessed various aspects of the district's internal control components and elements based on guidance by the Government Accountability Office

Conclusion

We found weaknesses in the district's administrative and internal accounting controls system, resulting in numerous findings that should be addressed and corrected by the district. These internal control weaknesses include:

- Significant deficiencies over fiscal functions
 - Inadequate cash handling procedures
 - Bank reconciliations were not prepared, reviewed, and approved in a timely manner
 - Insufficient policies and procedures over expenses
 - Lack of segregation of duties
 - Inadequate accounting software
 - Lack of an audit committee
- Deficiencies in maintaining supporting documentation
 - Unsupported indirect cost allocations
 - Lack of receipts and descriptions for credit card purchases
 - Lack of supporting documentation over inter-fund loans
- Lack of written policies and procedures
- Lack of commitment to competence
 - Lack of training policies
 - Performance evaluations were not performed in a timely manner

As part of our review, we assessed various aspects of the district's internal control components and elements based on the guidelines established by the Government Accountability Office's Internal Control Management and Evaluation tool. Of the 79 control elements evaluated pertaining to internal control components, we found 65 (82%) for which controls were considered to be inadequate, and one control element that was considered not applicable. The results of our review and evaluation of elements of internal control are included in this report as an Appendix.

The district should develop a comprehensive corrective action plan to address these deficiencies. The plan should identify the tasks to be performed, as well as milestones and timelines for completion. The Board of Directors should require periodic updates at public meetings of the progress in implementing the corrective action plan.

**Views of
Responsible
Officials**

We issued a draft review report on July 5, 2016. Peter Cosentini, Interim General Manager, responded by email on July 15, 2016. The district's response is included in this final review report as an attachment.

Restricted Use

This report is solely for the information and use of the Lamont Public Utility District and the SCO; it is not intended to be and should not be used by anyone other than these parties. This restriction is not intended to limit distribution of this report, which is a matter of public record.

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

July 29, 2016

Findings and Recommendations

Noncompliance with Government Code section 12464

Pursuant to Government Code section 12464, our review found the following reporting issues at the Lamont Public Utility District:

Financial Transactions Report for FY 2013-14:

- Enterprise Fund – Accounts Receivable was understated by \$675,723 (reported \$373,618 instead of the actual \$1,049,341).
- Enterprise Fund – Accounts Payable of \$491,046 was not reported.
- Enterprise Fund – Accrued Interest Payable of \$52,902 was not reported.
- Enterprise Fund – Other Current Liabilities of \$64,511 was not reported.
- Enterprise Fund – Other Revenues of \$25,289 was not reported.
- Enterprise Fund – Capital Contributions was understated by \$496,516 (reported \$280,315 instead of the actual \$776,831).
- Waste Enterprise – Connection Fees was understated by \$37,796 (reported \$38,857 instead of the actual \$76,653).
- Enterprise Fund – Interest Expense was understated by \$56,845 (reported \$176,486 instead of the actual \$233,331).
- Long-Term Debt – Loan Payable with the California Department of Public Health; \$192,083 outstanding balance was not reported.

Financial Transactions Report for FY 2012-13:

- Enterprise Fund – Cash and Cash Equivalents was understated by \$635,511 (reported \$3,547,847 instead of the actual \$4,183,358).
- Enterprise Fund – Accounts Receivable of \$386,256 was not reported.
- Enterprise Fund – Investments was overstated by \$639,375 (reported \$639,375 instead of \$0).
- Enterprise Fund – Total Fixed Assets was understated by \$2,428,749 (reported \$17,917,489 instead of the actual \$20,346,238).
- Enterprise Fund – Accounts Payable was overstated by \$369,853 (reported \$1,117,618 instead of the actual \$747,765).
- Enterprise Fund – Depreciation Expenses of \$523,230 was not reported.
- Enterprise Fund – Interest Expense was understated by \$98,346 (reported \$142,355 instead of the actual \$240,701).
- Waste Enterprise – Service Charges was understated by \$267,896 (reported \$644,886 instead of the actual \$912,782).

- Waste Enterprise – Connection Fees was understated by \$21,415 (reported \$2,550 instead of the actual \$23,965).
- Water Enterprise – Total Operating Revenues was understated by \$598,778 (reported \$1,373,446 instead of the actual \$1,972,224).

Recommendation

The district should consider the issues above when preparing future Financial Transactions Reports. The district's Financial Transactions Reports submitted to the SCO should include all year-end final closing adjustments. The district should also ensure that internal control findings and recommendations noted in this report are reviewed and evaluated for their impact on future reporting.

FINDING 1— Significant deficiencies over fiscal functions

We found significant control deficiencies over many of the district's fiscal functions. In particular, we noted the following:

- **Inadequate cash handling procedures**

The district's cash handling procedures were insufficient. From FY 2008-09 through FY 2012-13, the district's CPA firm, Daniells, Phillips, Vaughan & Bock (DPVB), reported numerous issues in the district's audited financial statements such as:

- Lack of segregation of duties
- Lack of independent reconciliations
- An inadequate system to reconcile cash receipts to general ledger detail
- Failure to reconcile the payment received and posted against customers' accounts to the amount received and deposited in their accounting software
- Lack of daily reconciliations of cash and checks

In addition, Kinsel Forensic Accounting LLP, an accounting firm hired by the district's insurance carrier, found that the district had insecure deposit procedures, and were missing deposit slips. The staff responsible for receiving cash should not have been responsible for making bank deposits. Furthermore, the staff responsible for making posts to the general ledger should not have been responsible for reconciliation.

Altogether, the lack of policies and procedures created an environment where errors had a high probability of going undetected.

DPVB performed a cash reconciliation analysis and found approximately \$224,045 missing in cash and check deposits. The firm's methodology was to reconcile and compare the cash receipts and checks per billing system with the district's accounting records, which were based on bank statements.

According to DPVB, missing amounts per fiscal year are as follows:

<u>Fiscal Year</u>	<u>Amount</u>
2010	\$ 25,385
2011	55,279
2012	49,312
2013	95,039
<u>July 2013 – December 2013</u>	<u>(970)</u>
Total Loss	<u>\$ 224,045</u>

Recommendation

The district should improve current cash handling procedures and perform monthly reconciliation of bank statements and general ledger to ensure accuracy of the cash balances. With the district's limited staff resources, it might be difficult to implement proper segregation of duties; however, as a compensating control, the district can implement more management oversight in the process and increase the frequency of bank deposits. Upper management such as a District Manager, Finance Manager, or Finance Director should monitor and document their review of the Office Manager's reconciliation reports for accuracy and to mitigate the possibility of fraud. If the district discovers variances, management should promptly investigate.

SCO's Comment

We revised the missing amounts noted in our draft review report to reflect the amounts provided by the district in its response to our draft review report.

- **Bank reconciliations were not prepared, reviewed, and approved in a timely manner**

In our review of the district's bank reconciliation process and procedures for the period of July 1, 2012, through June 30, 2014, we noted that the majority of the district's bank reconciliations were missing elements such as the preparer's name and date, and the reviewer's name and date.

During FY 2012-13, there were no official policies and procedures on bank reconciliations and no documentation of any review process.

For FY 2013-14, the district implemented policies and procedures to reconcile bank statements on a monthly basis. The district began signing and dating the bank reconciliations for March 2014 through June 2014, but the review process was still inadequate. We found that the district did not reconcile the bank statements with the general ledger, a step which may detect errors and fraudulent activity.

Cash can be the most vulnerable asset to an entity. Timely bank reconciliations provide the necessary control mechanisms to protect this valuable resource by uncovering irregularities such as unauthorized bank withdrawals. Timely preparation of monthly bank reconciliations also assists in the regular monitoring of the district's cash flows.

It is also essential that the duties of issuing payments, recording payments, and performing reconciliation be segregated.

Recommendation

The district should establish and implement policies and procedures for bank reconciliations to ensure that they are completed, reviewed, and approved in a timely manner. Management should review the reconciliation and investigate any variances at the end of the month to reconcile the outstanding amounts.

- **Insufficient policies and procedures over expenses**

During FY 2012-13, there was no indication that management reviewed the district's expenses. Additionally, invoices were not coded with the appropriate accounting code to assist in proper posting of the transaction. The district also did not employ control mechanisms for pre-approval of purchases.

It is important for management to review the expenses and approve of checks to help detect and deter fraud and errors. Coding the invoices is also an important procedure because it helps ensure that transactions are posted to the correct accounts. The district should consider using purchase orders to ensure management pre-approval of purchases. The use of purchase orders ensures that proper authorization is obtained and that funds are available before a purchase takes place.

Recommendation

To strengthen the district's internal control and enable more financial oversight, the district should establish and implement additional controls over expenses, such as dating and signing invoices, coding invoices, and establishing a purchase order process.

- **Lack of segregation of duties**

Proper segregation of duties helps to ensure that funds and assets are properly recorded, protected, and appropriated. During our review of the district's auditor reports on internal control, and of district employee duties, we noted that single individuals performed incompatible functions. The areas affected include journal entries, accounts payable, and cash receipts.

Journal Entries

A single individual prepared and posted all journal entries into QuickBooks; however, there was no evidence that journal entries were subsequently reviewed or approved by management. The district has recently improved this process by requiring the General Manager to sign off on journal entries and maintaining a permanent binder for journal entries.

Accounts Payable

The staff member responsible for accounts payable processed invoices, made entries in the general ledger, printed checks, and could also make updates to the vendor listing. This situation provides the opportunity and ability for a person to commit fraud by processing a fraudulent invoice, recording a false entry, and producing a live check.

Cash Receipts

The staff member responsible for opening mail, which often included checks, also posted payments into the billing system, prepared cash deposits, and took the deposits to the bank. The district has corrected this by hiring an armored car delivery service that delivers bank deposits several times per week.

Recommendation

The district should establish segregation of duties and/or compensating controls for activities such as preparing journal entries, processing accounts payable, and processing cash receipts.

- **Inadequate accounting software**

The district's accounting software does not completely separate water and sewer activity, which causes many issues such as:

- Difficulty performing periodic budget-to-actual reviews
- Inability to track and estimate revenues and expenses
- Inability to provide transparency
- Inability to provide assurances that the district adhered to all applicable laws and regulations

As a result, the district's current accounting software cannot be considered an implementation of fund accounting, which emphasizes accountability with its segregated set of self-balancing accounts. The Water Fund and Sewer Fund serve two distinct purposes and accounting records should accurately reflect their activities.

Without accurate reports, management is severely hampered and thus cannot assess situations and make well-informed decisions.

Recommendation

The district should establish fund accounting functionality by upgrading its existing accounting software or migrating to a new system. Management and staff should be trained on the theory and application of fund accounting to ensure that the district maintains a high level of financial reporting competency.

- **Lack of an audit committee**

The main purpose of an audit committee is to ensure that there is an adequate system of internal controls and to hire a CPA firm to audit its financial statements.

Without an audit committee, the district's financial reporting processes and internal controls might continue to deteriorate.

The district's lack of an audit committee contributed to:

- A lack of a comprehensive written administrative policies and procedures manual
- Failure to monitor and resolve repeated findings in audit reports
- Failure to issue audited financial statements in a timely manner

An audit committee is essential for a district's operations because it can:

- Improve financial practices/reporting and risk management policies/practices
- Discuss significant accounting and reporting issues to understand the potential effect on financial statements
- Ensure that there is a suitable and efficient internal control system in place to enhance the internal/external audit functions
- Review the district's internal controls for effectiveness or deficiency on the processes they affect
- Oversee and evaluate the auditor's performance and make a recommendation about whether or not to retain the same audit firm the following year
- Present the auditor's comments, findings, and/or recommendations and consider actions the district should take to correct and improve its financial reporting and management practices
- Provide a forum in which management, auditors, and other interested parties can meaningfully discuss and deliberate concerns and significant matters

Recommendation

The district should establish an audit committee with members who have knowledge of the accounting and financial reporting process to help serve in an advisory capacity to the Board on budget, investments, financial planning, audits, transparency, and other special oversight projects as determined by the Board.

**FINDING 2—
Deficiencies in
maintaining
supporting
documentation**

The district had deficiencies in maintaining supporting documentation over its financial transactions. Specifically, we found the following:

- **Unsupported indirect cost allocations**

During the review period, the district charged \$4,069,024 in indirect costs to the Water Fund and Sewer Fund that it could not support with documentation.

The costs charged to the Water Fund and Sewer Fund are as follows:

Indirect/Overhead Costs	FY 2012-13	FY 2013-14
Auto and truck repair and maintenance	\$ 18,628	\$ 18,728
Communication	15,902	13,711
Insurance expense	177,782	116,592
Laundry and uniforms	816	842
Mileage reimbursement	1,545	1,637
Miscellaneous expenses	15,852	32,373
Office-related expenses	82,377	101,498
Repairs and maintenances	49,058	606,207
Small tools	3,409	1,975
Software and computers expenses	13,599	9,339
Supplies	8,920	2,603
Uniform services	5,306	4,864
Equipment	28,569	32,530
Personnel expenses	754,688	844,051
Depreciation expenses	523,230	582,393
TOTAL	\$ 1,699,681	\$ 2,369,343

The district calculated the amounts by allocating 30% to the Sewer Fund and 70% to the Water Fund but could not explain and describe the methodology used. The district's allocations were based on estimated percentages that were not supported by auditable evidence.

Recommendation

The district should establish a methodology to calculate indirect cost and then create an allocation plan to ensure charges to the Water Fund and Sewer Fund are fairly allocated and properly supported.

- **Lack of receipts and descriptions for credit card purchases**

The district did not have formal policies and procedures regarding the use of credit cards for district business.

We tested transactions totaling \$34,527 from three of the district's credit cards for July 1, 2012, through June 30, 2014, and found that the district had receipts for \$9,554 only, 28% of the total expenses. Without receipts and descriptions, it is difficult to determine whether expenses are for district purposes. The aforementioned charges included meals, hotel stays, accessories purchases, and miscellaneous expenses.

The district also used an employee's personal credit card during times when it did not have its own, which bypasses many internal control mechanisms.

Recommendation

The district's management should review the credit card charges for adequate documentation, justification, and description for accountability per activity. The district should also establish policies and procedures to ensure that the supporting documentation is maintained at the district's premises. The district should use an expense reimbursement form if employee's personal credit card is used.

- **Lack of supporting documentation over inter-fund loans**

The district lacks written policies and procedures over inter-fund loans.

Also, the district is not properly monitoring the inter-funds loans between the Water Fund and Sewer Fund and could not provide supporting documentation other than the details from the general ledger.

Beginning in FY 1999-2000, the Water Fund loaned money of various amounts to the Sewer Fund for an undeterminable purpose. As of June 30, 2014, the outstanding loan balance is \$1,240,120.

The district could not conclusively explain why the loan was established. Furthermore, the district could not provide any terms of the loan such as whether the Water Fund will charge the Sewer Fund interest, how and when the Sewer Fund will pay back the Water Fund, and who approved the loan.

Recommendation

The district should develop and implement policies and procedures over inter-fund loans. Written policies and procedures should detail items such as:

- How inter-fund loans are authorized, whether by the General Manager or Board of Directors
- Circumstances in which they are allowed, and allowable uses
- Payback period and mechanism
- Interest to be charged

FINDING 3— Lack of written policies and procedures

During our review and inquiry with district staff and management, we noted that the district does not have a comprehensive policies and procedures manual in regards to contract renewals, credit card usage, information systems, capital assets and equipment, risk assessment, internal control monitoring and evaluation, and year-end closing procedures.

The district's lack of written policies and procedures are as follows:

- Contract renewal

The district does not have a contract renewal process to ensure it researches and receives competitive prices. There are policies and procedures in place for new contracts but not renewals.

- Credit cards

The district's Purchasing Policy does not clearly state authorization of credit cards, types of purchases allowed, documentation to substantiate expenses, regular statement reviews, and repercussions for ineligible personal uses. With proper internal controls in place, the district can ensure credit card payments and reimbursements are made for legitimate district purposes and reduce the risk of fraudulent activity and errors.

- Information systems

The district does not have written policies and procedures explaining the information systems controls regarding the backup of the accounting records and/or database. For example, the district switched to a new billing system software and did not run the old and new software simultaneously to ensure there were no issues with the transition. Also, there are no procedures in place to ensure periodic review of the feasibility of the district's most important information system, the accounting software.

- Capital assets and equipment

The district does not have written policies and procedures for equipment management controls such as purchases, approval and authorization, security of tangible assets, and inventory reconciliation. The controls mitigate the possibility of equipment being lost and stolen, helps maintain accurate inventory records, prevents unallowable purchases, and helps ensure equipment is properly depreciated.

- Risk assessment

The district does not have written policies and procedures that could help management identify risks relevant to financial statements, estimate the significance of each risk, assess the likelihood of the occurrence, and determine the best course of action.

- Internal control monitoring and evaluation

The lack of policies and procedures over internal control monitoring and evaluation raises the risk of operational ineffectiveness and inefficiency. Monitoring should involve periodically evaluating the effectiveness of controls and taking remedial actions when needed. It is often included in regular supervisory activities such as meetings with staff, and review of budget-to-actual reports.

In particular, the district should focus on purchasing and payment procedures, handling of cash and check payments procedures, and accounting errors due to a lack of oversight by management equivalent to an Accounting or Finance Director. The district can establish an audit committee to monitor the effectiveness of internal controls.

The lack of monitoring and evaluation activities contributed greatly to the district's numerous recurring issues.

- Year-end closing

The district's lack of written policies and procedures over year-end closing contributes heavily to their over-reliance of external auditors. Coupled with the district's history of late audits, this allowed many issues to go undetected. For example, the district's "Construction-in-progress" account was misstated for years until its auditors detected it.

We also found that the district was unable to provide supporting documentation for many year-end adjustments due to its reliance on external auditors. Ideally, the district should take the initiative in closing accounts and determining adjustments to allow the auditors to act as inspectors. This should greatly reduce errors.

- Expenses processing

As stated in Finding 1, the district lacks written policies and procedures in addition to many control activities over expenses processing.

- Inter-fund loans

As stated in Finding 2, the district lacks written policies and procedures over inter-fund loans.

Written policies and procedures are important to a district's operation because they provide an objective set of rules by which a district operates. Written policies and procedures also help establish the legitimacy of management action by ensuring that the application of management rules and decisions is performed in an objective, fair, and consistent manner. Finally, they help ensure that management and staff are held accountable for decisions that deviate from established procedures.

Recommendation

The district should develop a policies and procedures manual to ensure consistency with current processes and organizational structure. The district should also perform periodic and ongoing reviews to ensure proper documentation, accuracy, and completeness in its financial transactions and records. Changes in policies and procedures that occur between these periodic reviews should be updated and documented promptly. The policies and procedures manual should also indicate which employees are to perform which procedures. Procedures should be described as they are actually intended to be performed. In addition, the documentation of accounting policies and procedures should explain the design and purpose of procedures related to

controls in order to increase employee understanding of, and support for, the controls. The policies and procedures manual should be readily available to all employees. It should clearly state the authority and responsibility of all employees, especially the authority to authorize transactions and the responsibility for the safekeeping of assets and records.

**FINDING 4—
Lack of commitment
to competence**

We found significant control deficiencies due to the district's lack of commitment to competence. In particular, we noted the following:

- **Lack of training policies**

The district lacks formal training policies and procedures for its administrative staff which contributed to a lack of cross-training and succession planning. The district does not typically train its staff to perform back-up for other staff members, which can lead to a severe lapse in internal controls if a crucial member of the small team separates from the district. The district's lack of a comprehensive written policies and procedures manual compounds this effect.

This lack of back-up staff may impact the district's daily operation. For example, a delay in paying bills that are due will cause additional and unnecessary cost to the district. Likewise, delays in processing payroll will delay payments of salary to employees and processing of tax liability. These delays will cause additional costs in late payment penalties.

We also noted a lack of governmental accounting expertise among the staff, which contributed to its numerous issues.

Recommendation

The district should implement a remedial action plan to address the importance of experience and proper training of back-up staff when regular staff members are not available. Inexperienced staff may cause material impact in the district's operations in terms of additional costs, delays in processing financial transactions, and keeping management and the Board of Directors updated with accurate information.

Staff should be trained in the theory and application of governmental accounting.

- **Performance evaluations were not performed in a timely manner**

We found that the district did not regularly complete performance evaluations once the employees reach the top of their pay range.

It is important for an organization to demonstrate a commitment to attract, develop, and retain competent individuals in alignment with the organization's objectives. One of the tools commonly used to achieve this goal is evaluating employee performance. As a result of not performing employee evaluations on time, the district failed to comply with its human resources goals and commitment to competence.

Recommendation

The district's management should complete all of the past-due employee performance evaluations. Also, it should require that the district conduct employee performance evaluations on a regular basis in order to determine whether the knowledge, skills, and abilities of the employees are sufficient to perform their respective functions, and monitor this on a regular basis.

Appendix – Lamont Public Utility District Evaluation of Elements of Internal Control

Internal Control Elements		Yes	No	Comments
Management Oversight and Control (Control Environment)				
A1.	Integrity and Ethical Values			
	a. Are code of conduct and other policies regarding acceptable business practice, conflicts of interest, or expected standards to ethical and moral behavior established and communicated to all district management and employees?		X	The district did not adequately communicate code of conduct policies and internal control plan to employees, nor did it enforce it with disciplinary actions.
	b. Is the reasonable management attitude of “Tone at the Top” established and communicated to district management and staff?		X	See A1.a
	c. Is everyday interaction with vendors, clients, auditors and other parties based on honesty and fairness?	X		
	d. Is appropriate remedial action taken in response to non-compliance?		X	See A1.a
	e. Is management appropriately addressing intervention or overriding established controls?		X	See A1.a
A2.	Commitment to Competence			
	a. Is management identifying and defining the tasks required to accomplish particular jobs and fill various positions?		X	The district established job descriptions for current positions but is lacking someone with governmental accounting expertise.
	b. Does the district conduct appropriate analysis of the knowledge, skills, and abilities needed to perform job assignments?		X	See A2.a
	c. Is the district providing training and counseling in order to help employees maintain and improve their job competence?		X	See A2.a

A3. Audit Committee			
a. Does the district have an audit committee that is appropriate for the size and nature of the entity?		X	The district had a finance committee that only met a couple of times. Meeting minutes were unavailable for review. It did not appear to perform the duties of an audit committee, which includes ensuring there is an adequate internal control structure and hiring a CPA firm to audit its financial statements.
b. Are members of the audit committee independent from the district management?		X	See A3.a
c. Do audit committee members have sufficient knowledge, experience, and time to serve effectively?		X	See A3.a
d. Does the audit committee meet regularly to set policies and objectives, review the district's performance, and take appropriate actions; and are minutes of such meetings prepared and signed on timely basis?		X	See A3.a
e. Do the members of the audit committee regularly receive the information they need to monitor management's objectives and strategies?		X	See A3.a
f. Does the audit committee review the scope and activities of the internal and external auditors?		X	See A3.a
g. Does the audit committee meet privately with the Chief Financial Officer and/or accounting officers, internal auditors, and external auditors to discuss the reasonableness of the financial reporting process, the system of internal control, significant comments or recommendations, and management performance?		X	See A3.a
h. Does the audit committee take actions as a result of its audit findings?		X	See A3.a
A4. Management Philosophy and Operating Style			
a. Is management conservative in accepting risks, and does management move carefully, and proceed only after careful evaluation?		X	The district lacks formal risk assessment procedures, such as periodic budget-to-actual reviews and investigations of cash receipts variances.
b. Are procedures or activities in place to regularly educate and communicate to management and employees the importance of internal controls and to raise the level of understanding control?		X	The district does not have an audit committee or a comprehensive written policies and procedures manual.

	c. Is personnel turnover in key functions at an acceptable level?		X	The district experiences high turnover for the General Manager position and has not replaced its Financial Consultant.
	d. Does management have a positive and supportive attitude towards internal control and audit functions?		X	The district does not have an audit committee. Audit reports were prepared extremely late.
	e. Are valuable assets and information safeguarded from unauthorized access or use?		X	The district does not perform regular inventory checks.
	f. Are there frequent interactions of senior management and operation management?	X		
	g. Is management attitude appropriate towards financial, budgetary, and other operational reporting?		X	Budget-to-actual reports are not reviewed.
A5. Organizational Structure				
	a. Is the district's organizational structure appropriate for its size and the nature of its operation?		X	The district lacks an employee with extensive governmental accounting knowledge. An additional employee will also help alleviate the lack of segregation of duties.
	b. Are key areas of authority and responsibility defined and communicated throughout the organization?	X		
	c. Have appropriate and clear reporting relationships been established?	X		
	d. Does management periodically evaluate the organization's structure and make changes as necessary in fluctuating conditions?		X	See A5.a
	e. Does the district employ an appropriate number of employees, particularly in managerial positions?		X	See A5.a
A6. Assignment of Authority and Responsibility				
	a. Is the district appropriately assigning authority and delegating responsibility to the proper personnel to deal with organizational goals and objectives?	X		

	b. Does each employee know how his or her work interrelates to others in the way in which authority and responsibility are assigned, and how duties are related concerning internal control?		X	The district lacks a polished comprehensive written policies and procedures manual.
	c. Is delegation of authority appropriate in relation to the assignment of responsibility?	X		
A7. Human Resources Policies and Practices				
	a. Are policies and procedures established for hiring, training, and promoting employees and management?	X		
	b. Are background checks conducted on candidates for employment?	X		
	c. Are employees provided the proper amount of supervision?		X	See A5.a
Risk Assessment				
B1. Establishment of Entity-wide Objectives				
	a. Are there entity-wide objectives that were established by management?	X		
	b. Are district-wide objectives clearly communicated to all employees, and does management obtain feedback signifying that communication has been effective?	X		
	c. Is there a relationship and consistency between the department's operational strategies and the district-wide objectives?		X	The district's internal control structure is missing many key components of a well-run local governmental agency. For example, the district's cash handling procedures and expense control mechanisms were inadequate for many years.
	d. Is there an integrated management strategy and risk assessment plan that considers the district-wide objectives and the relevant sources of risk from internal management factors and external sources, and that establishes a control structure to address those risks?		X	See B1.c

B2. Risk Identification			
a. Is management appropriately and comprehensively identifying risk using various methodologies?		X	See B1.c
b. Are there mechanisms in place to anticipate, identify, and react to routine events or acts that affect achievement of objectives?		X	See B1.c
c. Do adequate mechanisms exist to identify risks to the district arising from external factors?		X	Employees work in an unsecured area without a physical barrier from the public. Employees reported getting robbed and assaulted on the premises.
d. Is management assessing other factors that may contribute to or increase the risk to which the district is exposed?		X	Management does not have mechanisms in place to identify risks posed by new legislation, economic changes, risks associated with major supplies and contractors, and certain human capital-related risks such as the inability to provide for succession planning.
e. Is management identifying risks district-wide and for each significant activity level of the district?		X	See B1.c and B2.d
B3. Risk Analysis			
a. After risks to the district have been identified, does management undertake a thorough and complete analysis of the possible effect?		X	See B1.c and B2.d
b. Has management developed an approach for risk management and control based on how much risk can be prudently accepted?		X	See B1.c and B2.d
Control Activities			
C1. Policies and Procedures (General Applications)			
a. Do appropriate procedures, techniques, and mechanisms exist with respect to each district's activities?		X	See B1.c and B2.d
b. Are the control activities identified as necessary in place and being applied?		X	See B1.c and B2.d
c. Are control activities regularly evaluated to ensure that they are still appropriate and working as intended?		X	See A3.a

C2.	Common Categories of Control Activities			
	a. Are top level reviews made of actual performance relative to budgets, forecasts, and prior periods?		X	The district does not perform periodic budget-to-actual reviews.
	b. Do managers review performance reports?		X	See C2.a
	c. For information processing, are varieties of controls in place for performing check accuracy, completeness, and authorization of transactions?	X		
	d. Are controlled items periodically counted and compared to amounts shown on control records?		X	The district regularly performs checks of its warehouse supplies but not its office equipment.
	e. For performance indicators, does management compare different sets of data and investigate differences?		X	See C2.a
	f. Are duties properly segregated among different people to reduce the risk or error or inappropriate actions?		X	See Finding 1
	g. Are administrative and operation policies in writing, current, and do they set clear procedures for compliance?		X	See Finding 3
Information and Communication				
D1.	Information			
	a. Are mechanisms in place to obtain relevant information on legislative or regulatory developments and program, budget, or economic changes?		X	See B2.d
	b. Is information provided to the right people in sufficient detail and on time to enable them to carry out their responsibilities efficiently and effectively?		X	See C2.a and Finding 1 (Inadequate accounting software)
	c. Is development or revision of information systems based on the strategic plan linked to the entity's overall strategy, and is it responsive to achieving district-wide objectives?		X	See C2.a and Finding 1 (Inadequate accounting software)

	d. Does management support the development of necessary information systems and show its support by committing appropriate resources?		X	See C2.a and Finding 1 (Inadequate accounting software)
D2.	Communications			
	a. Does management ensure that effective internal communications occur?		X	The district does not have regular budget meetings or review budget-to-actual reports. A comprehensive written policies and procedures manual has not been established, which is a formal method of internal communication. See Finding 3
	b. Does management ensure that effective external communication occurs regarding issues with serious impact on programs, projects, and other activities?		X	The district did not prepare audited financial statements in a timely manner.
	c. Does the district employ various forms and means of communicating important information with employee and others?		X	See D2.a
	d. Does the district manage, develop, and revise its information systems in an effort to continually improve usefulness and reliability?		X	See D2.a and Finding 1 (Inadequate accounting software)
Monitoring				
E1.	On-going Monitoring			
	a. Does management have a strategy to ensure that ongoing monitoring is effective and will trigger separate evaluations?		X	The district does not have an audit committee, did not properly monitor its cash receipts, did not review budget-to-actual reports, and did not prepare audited financial statements in a timely manner.
	b. Do district personnel, in the process of performing their regular duties, obtain information about whether internal control is functioning properly?		X	The district did not properly monitor its cash receipts and did not perform periodic reviews of budget-to-actual reports.
	c. Are communications from external parties corroborated with internally generated data and able to indicate problems with internal control?	X		
	d. Is there appropriate organizational structure and supervision to help provide oversight of internal control functions?		X	There was significant turnover in the General Manager position and the district lacks a Finance Director.
	e. Are data recorded by information and financial systems periodically compared with physical assets and discrepancies?		X	The district does not perform periodic inventory checks.

	f. Are the district Auditor's Office and other auditors regularly providing recommendations for improvements in internal control, and is management taking appropriate follow-up action?		X	Management is not resolving findings in a timely manner. The district's auditors found that repeated findings and issues such as the cash handling procedures were not promptly fixed.
	g. Are meetings with employees used to provide management with feedback on whether internal control is effective?		X	See E1.a
	h. Are employees' regularly asked to state explicitly whether they comply with the district's code of conduct?		X	Employees are only explicitly asked during orientation when they were hired.
E2.	Separate Evaluation			
	a. Are the scope and frequency of separate internal control evaluations appropriate for the district?		X	The district lacks internal control evaluation policies and procedures. See A4.d and E1.f
	b. Are the methodologies for evaluating the district's internal control logical and appropriate?		X	See E2.a
	c. If the evaluations are conducted by the district Auditor's Office, does the office have sufficient resources, ability, and independence?			N/A
	d. Are deficiencies found during separate evaluations promptly resolved?		X	Findings were repeated frequently and were not resolved in a timely manner.
E3.	Reporting Deficiencies			
	a. Are there means of obtaining reports of deficiencies from both internal and external sources?		X	See E1.a
	b. Is there ongoing monitoring of internal controls?		X	See E1.a
	c. Are deficiencies reported to the person directly responsible and to a person at least one level higher?	X		
	d. Are the identified transactions or events investigated to determine causes and correct problems?		X	See B1.c

**Attachment—
District's Response to
Draft Review Report**

July 15, 2016

Memo:

To: State Controller's Office, Mr. Jeffrey Brownfield, and Chief Division of Audits

From: Peter Cosentini, Interim General Manager of the Lamont Public Utility District

Subject: District Response to the State Controller's Review of the District's Administrative and Internal Accounting Controls

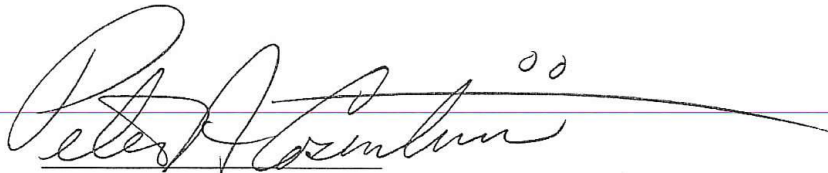
I want to take this opportunity to thank the State Controller's Office for their review which will assist the District in their current positive evolution as a governmental agency.

The one technical point the District would make is the amount of money that was lost between 2010 and 2013. The attached summary from Daniells Phillips Vaughan & Bock Accountancy Corporation places the lost amount at \$224,045. Your staff had an estimate of \$249,682.

In addition, and in the Districts on going pursuit to evolve in a positive way as a public agency, the District has adopted, since the review period, the following new policies to help with administrative, accounting and internal controls. They are as follows:

1. Administrative Fine Procedures for Ordinance 111, adopted 1-15-16
2. Capital (Fixed) Assets Policies and Procedures, Adopted 8-24-14
3. Certification Incentive Policy, adopted 10-27-14
4. Amended Conflict of Interest Code, Adopted 9-22-14
5. Purchasing Policy, Adopted 4-27-15
6. Record Retention and Destruction Policy, Adopted 1-26-15
7. Sick Leave Benefits Policy, Adopted 7-27-15
8. Vacation Benefits Policy, Adopted 1-25-16

Sincerely,

A handwritten signature in black ink, appearing to read "Peter Cosentini", with a long horizontal flourish extending to the right. There are two small circles above the end of the signature.

Peter Cosentini
Interim General Manager

Attachment: Summary of AR Comparison Between RVS and Cash Account

LPUD
Cash/Check Comparison between RVS and QB

July 2009 - December 2013

CASH

	Cash Collections per billing sys	Cash Collections Per QB	Adjustment for deposit to wrong bank account	Excess (deficiency)
July 2009	116,083	116,580		497
August 2009	120,111	111,345		(8,766)
September 2009	112,369	110,163		(2,206)
October 2009	121,890	116,623		(5,267)
November 2009	110,874	89,935		(20,939)
December 2009	109,507	116,400		6,893
January 2010	108,126	104,856		(3,270)
February 2010	110,206	91,730		(18,476)
March 2010	108,565	127,543		18,978
April 2010	106,376	98,511		(7,865)
May 2010	105,884	133,517	(8,071)	19,562
June 2010	114,667	110,141		(4,526)
	<u>1,344,658</u>	<u>1,327,344</u>	<u>(8,071)</u>	<u>(25,385)</u>
July 2010	116,660	111,255	(9,815)	(15,220)
August 2010	115,188	127,379	(8,908)	3,284
September 2010	126,739	128,899	(7,980)	(5,820)
October 2010	112,521	110,894	(8,181)	(9,809)
November 2010	115,345	122,929	(7,402)	182
December 2010	101,066	106,778	(7,423)	(1,712)
January 2011	109,659	105,188	(7,395)	(11,866)
February 2011	110,301	89,497	(7,239)	(28,043)
March 2011	108,922	127,289		18,367
April 2011	106,976	99,427		(7,550)
May 2011	109,045	113,409		4,365
June 2011	114,856	128,171	(14,773)	(1,459)
	<u>1,347,278</u>	<u>1,371,114</u>	<u>(79,116)</u>	<u>(55,280)</u>
July 2011	115,652	109,928		(5,724)
August 2011	124,851	120,971		(3,880)
September 2011	129,604	121,788		(7,817)
October 2011	114,927	111,390		(3,537)
November 2011	114,714	105,168		(9,546)
December 2011	108,117	115,838		7,721
January 2012	113,804	112,315		(1,489)
February 2012	113,646	84,461		(29,184)
March 2012	118,119	139,883		21,764
April 2012	106,330	94,644		(11,686)
May 2012	109,600	108,480		(1,121)
June 2012	119,548	114,733		(4,815)
	<u>1,388,911</u>	<u>1,339,599</u>	<u>-</u>	<u>(49,313)</u>
July 2012	124,047	129,081	(6,972)	(1,938)
August 2012	135,522	105,983		(29,539)
September 2012	114,070	108,292		(5,778)
October 2012	127,471	143,330		15,859
November 2012	122,323	93,545		(28,778)
December 2012	109,578	108,044		(1,534)
January 2013	112,000	109,566		(2,434)
February 2013	114,069	93,888		(20,181)
March 2012 (RVS)	65,278	121,621		56,343
March 2013 (Cubics)	62,502			(62,502)
April 2013	108,233	99,743		(8,490)
May 2013	118,660	119,709		1,030
June 2013	118,601	111,505		(7,096)
	<u>1,432,374</u>	<u>1,344,307</u>	<u>(6,972)</u>	<u>(95,039)</u>
July 2013	129,213	132,792		3,579
August 2013	130,631	125,457		(5,174)
September 2013	120,430	126,159		5,729
October 2013	126,484	128,165		1,681
November 2013	117,033	118,402		1,369
December 2013	121,536	115,322		(6,214)
	<u>745,327</u>	<u>746,297</u>	<u>-</u>	<u>970</u>
Total	<u>6,258,547</u>	<u>6,128,661</u>	<u>(94,159)</u>	<u>(224,045)</u>

**State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250-5874**

<http://www.sco.ca.gov>