3. Managing Financial Data and Information

- **Significant weaknesses in the way the Public Utilities Commission captures and reports financial data and information impair management's ability to report on the results of operations, monitor expenditure and budgetary control, and assess performance overall and in select areas.**

- **The Public Utilities Commission's independent financial auditors have identified significant issues in the General Ledger and Financial Reporting area including poor internal communications, insufficient experience and skill level on the part of staff, lack of documentation, and lack of analysis and management review. Indeed, for two years in a row, the management letters recommended that staff accountants obtain training on technical issues, financial reporting and account analysis - skills that should have been brought to the job given the nature of the work assignments. While improvements have been made and no management letter was issued by the independent auditors for FY 2003-2004, several management tools, including a training program, are still not in place. Proper implementation of these tools would improve the financial reporting process, minimize the risk that errors may not be identified during the audit process, and reduce rework.**

- **Additionally, the Public Utilities Commission's current configuration and use of its accounting structure impedes management's ability to track, monitor and report on the costs of operations. Most significantly, the Public Utilities Commission does not clearly segregate certain routine maintenance, repair and replacement, and capital expenditures. Despite a clear and articulated need for expenditure and budgetary control, management accountability and reporting requirements in this area from the California Department of Finance and Department of Health Services, the Bay Area Water Supply and Conservation Agency, and the Public Utilities Commission's independent financial auditors, this issue still has not been addressed. As a result, the Public Utilities Commission has difficulty in capturing and summarizing necessary financial data and information and is unable to implement effective asset management.**

- **The Public Utilities Commission has also had a proliferation in index codes and there has been little oversight or control over index code creation. The Controller's Office reports that there have been approximately 5,839 active Public Utilities Commission index codes used from FY 1998-1999 to date: 4,677 related to capital activities and 1,162 related to operating activities. For operations, index codes are an appropriate mechanism to capture financial data and information relative to an organization's various functions and activities, or its cost centers, and a proliferation in index codes inhibits management's ability to assess performance in meaningful operational areas. While the Financial Services Section is currently evaluating its index codes and reducing and revising the accounting structure accordingly, there continues to be no established policies and procedures, criteria, or framework for creating new index codes.**

- **Several basic management tools should be put into place to ensure that financial data and information is accurate, complete, timely and useful. These tools include written policies and procedures, clearly defined roles and responsibilities, and a revised accounting structure that is stable so that financial data and information can be compared over time.**

Financial data and information is critical to the success - or failure of an organization. Accurate, complete, timely and useful financial data and information enables management to report on the results of operations, monitor expenditure and budgetary control, and assess performance overall and in select areas. Thus, it is imperative that processes are in place to maintain accurate, complete, timely and useful financial records.

Annual Audit Process and Management Letters

The financial reporting and annual audit process provide valuable tools to assess the performance of the financial reporting function. As the Public Utilities Commission's financial system of record, FAMIS is critical to producing accurate financial reports, which is contingent upon the Public Utilities Commission's own accounting processes. One effective measure of the accounting processes is to track and monitor the number of audit adjustments required at year-end to produce accurate financial statements[1]. These adjustments should be minimized in order to expedite the financial reporting process, to minimize the risk that errors may not be identified during the audit process, and to reduce the number of errors identified that have to be corrected. However, the Accounting Unit has not developed a mechanism to track and monitor these adjustments. The Director of Accounting should develop lead sheets and schedules at year-end of account balances and

[1] For purposes of this report, audit adjustments are defined as accounting entries that are required due to error or lack of timeliness in the accounting process and exclude routine year-end closing entries or the posting of estimated year-end balances and transactions.

track and monitor all adjustments made subsequent to year-end closing in order to identify process weaknesses that can be rectified in the subsequent year.

In addition to audit adjustments to the financial reports, the independent financial auditors also provide management letters when issues have come to their attention that require disclosure. Typically, management letter comments pertain to weaknesses identified in an organization's internal controls. The management letter for FY 2002-2003, issued March 25, 2004 identified significant issues, several of which were also findings in the previous year. The findings included poor internal communications, insufficient experience and skill level on the part of accounting staff, lack of documentation and lack of analysis and management review. Most notably, the management letters dated March 25, 2004 and January 20, 2003 actually recommended that management provide "periodic training on technical issues, financial reporting and account analysis as needed for each individual in the accounting section." These are skills that staff accountants in the Accounting Unit, especially in the General Ledger and Financial Reporting area, should bring to the job.

In response, management initiated regular staff meetings and improved financial analysis and reporting procedures. Recent improvements also include expanded reporting capabilities for capital assets and capital asset reconciliation. Further, the Accounting Unit significantly increased its management oversight of the year-end close and audit processes last fiscal year, and, coupled with weekly meetings and assistance from the Controller's Office, no management letter was issued for FY 2003-2004.

To sustain these improvements and implement more process efficiencies, several fundamental management tools should be put into place. These include:

- The development of written, detailed policies and procedures for General Ledger and Financial Reporting area;

- Augmentation of the check list of required data and information to be complied or accumulated for the annual financial statement audit by including the actual completion date so that performance can be monitored and problem areas can be identified; and

- Development of a training needs assessment and a formalized training plan for each staff which includes details on classes or other means of obtaining the training and stated timelines.

The Director of Accounting should annually assess the year-end close and financial reporting process, using the log of audit adjustments and the Prepared by Client checklist with actual timelines to implement improvements for the subsequent year.

Accounting Structure Issues

Routine Maintenance, Repair and Replacement, and Capital Project Accounting

The Public Utilities Commission does not have uniform policies, procedures and accounting structures that clearly capture and segregate financial data and information and reporting on its routine maintenance, repair and replacement activities, and capital projects. As discussed in detail in the previously released *Phase III Management Audit of the Public Utilities Commission - Water Enterprise Fund*, Section 2, the Public Utilities Commission has commingled these activities related to the Water Enterprise although these activities meet different organizational goals and require disparate accounting treatment. The accounting structure should segregate these activities for budgetary and expenditures control and reporting purposes. Further, these objectives are directly linked to the goals of an asset management program as discussed in Section 2 of this report.

Despite a clear and articulated need for expenditure and budgetary control, management accountability and reporting requirements in this area from the California Department of Finance and Department of Health Services, the Bay Area Water Supply and Conservation Agency and the Public Utilities Commission's independent financial auditors, this issue still has not been addressed. First, the roles and responsibilities of vested parties within the Public Utilities Commission, including the Accounting, Budget and Finance units of the Financial Services Section and the Infrastructure Division's project managers and its Infrastructure Resources Management Bureau, must be defined and expressly documented and communicated. Because the Financial Services Section should be both the expert, in terms of financial data, information and systems requirements, as well as the control and oversight body, the Financial Services Director is ultimately responsible for ensuring that an appropriate framework is established and complied with. Second, activities that constitute routine maintenance, repair and replacement, and capital projects must be clearly defined, expressly documented and communicated. Third, the accounting structure, or its use, must be revised to segregate these activities, in conjunction with segregating expenditures that should be capitalized as an asset from those expenditures that should be categorically expensed, as discussed in *Phase III Management Audit of the Public Utilities Commission - Water Enterprise Fund*, Section 2. Concurrently to all of these steps, policies and procedures should be developed that document, support and control these efforts including appropriate budgeting, transaction processing, and reporting.

Index Codes

Between the three Public Utilities Commission Enterprises as well as the Public Utilities Commission Administrative Bureaus, the Department reports that over 25,000 index codes have been used to account for various operating and capital activities within the Department's three main operating funds and 20 plus programs. However, the Controller's Office reports that active index codes - that is index codes used from FY 1998 to date - total 5,839, which is still a considerable number. Index codes are exclusive to each fund, division and project, if applicable. Therefore, if an activity crosses divisions, there may be several index codes used to capture the relevant financial data and information. For example, a capital project may not only have separate index codes for each project phase (planning, design, construction, etc.), but if several divisions or programs are charging expenditures to the capital project, there has to be a unique set of index codes for each division or program. So, if there are four project phases and five programs involved, 20 index codes would have to be established in the financial accounting system (FAMIS) to capture and control project expenditures.

Historically, there have been no established policies and procedures, criteria, or framework for creating index codes. Rather, any staff requiring a separate accounting for a specific activity would request the Financial Services Section to create a new index code. Thus, index codes proliferated without any oversight or control.

For capital projects, because expenditures are controlled and managed by project, index codes have little significance and, according to the Controller's Office, approximately 4,677 of the 5,839 index codes pertain to capital projects. However, for operations, index codes are the appropriate mechanism to capture financial data and information relative to an organization's various functions and activities, or its cost centers, and a proliferation in index codes inhibits management's ability to assess performance in meaningful operational areas. According to the Controller's Office, the Public Utilities Commission's operating index codes total approximately 1,162. This past year, the Financial Services Section has been reviewing and reducing index codes division by division. At this time, Hetch Hetchy and Clean Water have been completed as well as the Water Supply and Treatment Division of the Water Enterprise Department, which has reduced its operating index codes from 192 to 20.

The Financial Services Section, while making sure that certain data and information is appropriately captured for the annual financial reporting and audit process as well as for the suburban water rate calculation, has deferred to the division managers to establish the index codes according to their operational needs. As a control point, the Financial Service Section reports that no new index code will be added unless it has been approved by the division manager. Thus, individual staff will no longer be able to add index codes at will. Additionally, the Financial Services Section reports the intention in the next year is to develop a chart of accounts and index codes that conform to industry standards for utilities.

A rational accounting structure and chart of accounts, based on a framework of organizational functions and activities, is important to capture and report useful financial data and information. A chart of accounts should not be developed through ad hoc requests, but rather through a comprehensive and analytical approach to the organization's financial data and information needs. The Financial Services Section has started the right steps to developing a meaningful and useful chart of accounts. However, significant work remains to be done and steps should be taken to ensure that not only is the process completed, but that it meets the end goal of developing a meaningful and useful chart of accounts.

First, the process of revising the Public Utilities Commission's index codes and accounting structure should be formalized with written instructions and guidance for division managers in order to ensure that the structures are standardized, to the extent possible, across divisions and programs and to incorporate appropriate cost methodologies. Further, industry standards should be incorporated now because continuously revising accounting structures impairs an organization's ability to compare financial data and information over time as well as requires additional resources every time a recast is conducted. Again, a rational accounting structure and chart of accounts, based on a framework of organizational functions and activities, should be appropriately established and it should remain relatively constant. Finally, the Financial Services Section should formalize policies and procedures for the development of new index codes and assign responsibility within the Financial Services Section and in the various divisions for maintenance of the accounting structure.

Conclusions

Weaknesses in the way the Public Utilities Commission captures and reports financial data and information impair management's ability to report on the results of operations, monitor and control expenditures, establish meaningful appropriation and budgetary controls and assess financial performance. Several basic management tools should be put into place to ensure that financial data and information is accurate, complete, timely and useful.

Recommendations

The Director of Accounting should:

3.1 Develop lead-sheets and schedules of account balances and track and monitor all audit adjustments for the FY 2005-2006 year-end close and financial audit process.

3.2 Augment the "Prepared by Client" listing with actual completion dates and track and monitor deadlines for the FY 2005-2006 year-end close and financial audit process.

3.3 Annually assess performance or process issues identified in 3.1 and 3.2 above and implement improvements as necessary.

3.4 Develop written policies and desk procedures for the General Ledger and Financial Reporting area by March 30, 2006.

3.5 Develop a training needs assessment and a formalized training plan for each staff and monitor as part of the employee evaluation process by December 31, 2005.

The Director of Financial Services should:

3.6 Define and document the roles and responsibilities of vested parties within the Public Utilities Commission related to capturing critical financial data and information, including the Accounting, Budget and Finance units of the Financial Services Section and the Infrastructure Division's project managers and its Infrastructure Resources Management Bureau by December 31, 2005.

3.7 Clearly define and document routine maintenance, repair and replacement, and capital activities by December 31, 2005.

3.8 Revise the accounting structure and its use in budgeting, transaction processing and reporting to segregate routine maintenance, repair and replacement, and capital activities, in conjunction with segregating expenditures that should be capitalized as an asset from those expenditures that should be categorically expensed by March 31, 2006.

3.9 Develop written policies and procedures for all staff in the Financial Services Section as well as in operations to provide practical guidance on the implementation of 3.8 above by June 30, 2006.

3.10 Develop written instructions and guidance on the revision of the Public Utilities Commission's index codes, including detail on the index codes to be standardized across divisions if applicable, incorporation of industry standards, and documentation of any external reporting requirements by December 31, 2005.

3.11 Develop written policies and procedures for the on-going creation of new index codes by December 31, 2005.

Costs and Benefits

Implementation of these recommendations should be accomplished with existing resources. The benefits include significant future savings through vastly improved expenditure and budgetary control, improved performance evaluation of both staff and programs, and a reduced risk that financial data and information may be inaccurate or misleading.