TRANSBAY JOINT POWERS AUTHORITY

Board Policy No. 007 Category: Financial Matters

INTERNAL ACCOUNTING CONTROL POLICY

The Transbay Joint Powers Authority (the "TJPA" or "Authority") is a joint powers agency organized and existing under the laws of the State of California. Pursuant to the Joint Powers Agreement creating the TJPA, dated April 4, 2001 (the "Agreement"), the TJPA has the authority to make and enter into contracts, to acquire real and personal property and to exercise all powers necessary and proper to carry out the provisions of the Agreement.

The Board of Directors of the Transbay Joint Powers Authority (TJPA) acknowledges the special responsibility it has to provide assurances to taxpayers and grantors that public funds and property are properly safeguarded by adequate controls. It is the policy of the TJPA Board of Directors that the fiscal affairs of the TJPA will be conducted in accordance with sound administrative and internal accounting controls. The TJPA systems of internal control will provide the basic foundation on which the accountability structure must be built. Further, it is the Board's policy that the TJPA Chief Executive Officer (CEO) and the TJPA Chief Financial Officer (CFO) develop and maintain effective internal control systems in accordance with the TJPA Board's Internal Accounting Control Policy. This policy recognizes that internal control systems may require modification from time to time, due to changes in TJPA staffing, new funding allocations, grant requirements, or other events that may occur in the normal course of business. All such changes will be approved by the TJPA CEO and CFO and reviewed by TJPA staff.

I. BACKGROUND

Internal accounting controls establish a framework to provide the TJPA with assurances that assets of the Authority are reasonably safeguarded, financial transactions are executed as authorized, and transactions are properly recorded. Under the leadership of the TJPA CEO and CFO, the TJPA will develop an effective internal accounting control system in a rational and systematic manner that will establish an environment that creates the appropriate control awareness, attitude and discipline. The control system will fit the organization and its operating philosophy, focus on areas of inherent risk, and achieve a thoughtful balance between control costs and benefits (reasonable assurance).

II. DEFINITION OF INTERNAL CONTROL

For the purposes of this Accounting Control Policy, the TJPA defines "Internal Controls" as a plan of organization and all of the methods and procedures (techniques) the management adopts to help it achieve six basic management objectives:

- Ensure adherence to laws, regulations, and policies;
- Ensure that reliable data are obtained, maintained, and properly disclosed in reports;
- Promote economy, efficiency, and effectiveness of operations;
- Safeguard resources against loss due to errors or irregularities;
- Alert senior officials to departures from established policies and procedures; and
- Detect activities which have not been properly authorized or which undermine the achievement of organizational goals and objectives.

III. INTERNAL ACCOUNTING CONTROLS

For the purposes of this Accounting Control Policy, the TJPA's Internal Controls will be designed to safeguard the Authority's assets and ensure the reliability of financial records. Consequently, the Internal Controls must be designed to provide reasonable assurance that:

- Transactions are executed in accordance with management's general and specific authorization;
- Transactions are recorded as necessary to permit preparation of:
  - Management and control reports,
  - Compliance and other grantor reports,
  - Financial statements in conformity with generally accepted accounting principles and,
  - Reports that maintain accountability for assets;
- Access to assets is permitted only in accordance with management's authorization; and
- The recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

Control Techniques – The TJPA's policy addresses two important control techniques that are used in any internal accounting control system: the segregation of duties within the system and procedural controls, which govern the flow of transactions through the system. The internal accounting control achieved by a particular system depends on:

- The way responsibility for transaction execution is segregated to create checks and balances; and
- The actual activities and control procedures adopted and the way they are executed.

A. Segregation of Duties – It is the Board's policy that the assignment of duties to individuals will be segregated in such a fashion that no one individual controls all phases of the processing of a transaction, thereby creating a situation which permits errors of omission or commission to go undetected. The flow of activities will be designed so that the work of one individual is either independent of, or serves as a check on, the work of another. For example, the billing and collection functions will be segregated since combining these functions could permit concealment of an unauthorized diversion of collections.

Due to limited staff, an increase in the TJPA officials' involvement in the monitoring of procedures then becomes essential and serves as a compensating control. The TJPA Chief Executive Officer and Chief Financial Officer will have a strategic role in monitoring transaction authorization, processing and reporting. In addition, the TJPA's financial records and financial statements will be audited annually. The annual audit will include an evaluation of the adequacy of and the degree of compliance with the TJPA's system of internal accounting control. The annual audit report will be submitted to the TJPA Board of Directors.

As a practical matter, the principle of segregation of duties must be tempered by considering such variables as volume, complexity and financial significance of differing types of transactions and the sequence of steps necessary to process them. A continuing concern is the cost of maintaining controls in relation to the risk of loss due to error or fraud that might arise in their absence. Because of the cost of implementing segregation of duties control techniques, TJPA officials may decide to accept certain risks by combining a number of responsibilities or functions. The implications of such combination must be thoroughly considered by the TJPA staff before implementation.

B. **Procedural Controls –** TJPA staff will clearly state the internal control objectives in the development of procedural controls. Although a wide choice may exist in the selection of systems and procedures used to process similar types of transactions, TJPA staff must evaluate the specific procedures based on whether or not they reasonably accomplish their objectives.

IV. INTERNAL ACCOUNTING CONTROL LIMITATIONS

TJPA recognizes that there are inherent limitations in any system of internal accounting controls. These limitations are as follows:

- In the performance of most control procedures, errors can result from misunderstanding of instructions, mistakes of judgment, carelessness, or other personal factors;
- Control procedures whose effectiveness depends upon segregation of duties can be circumvented by collusion; and
- Control procedures with respect to the execution and recording of transactions may be ineffective against either errors or irregularities perpetrated by administrators or managers or inappropriate estimates and judgments by them in the preparation of financial statements.

Any projection of a current evaluation of internal accounting control to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions and that the degree of compliance with the procedures may deteriorate.

These limiting factors must not impair TJPA staff's efforts to develop an effective internal accounting control system.