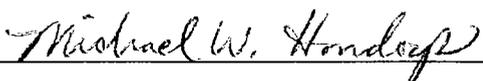


**MWD**

METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

February 25, 1997

To: Board of Directors**From:** Auditor

SUBJECT: Audit Department Report for February 1997

RECOMMENDATION

For information only.

DETAILED REPORT

This report highlights significant activities or accomplishments of the Audit Department during February 1997. Transmitted as an attachment is a listing of audit assignments for which staff effort was expended during the month.

Efforts in February included completion of our assistance to KPMG Peat Marwick's staff in conducting the audit of the District's cash basis financial statements as of and for the six months ended December 31, 1996. Those financial statements were transmitted to the Board at month-end. Planning was also performed relating to several pending audits using contract audit services, including an audit of the District's electrical utility and regular telephone billings, which will be conducted by a specialist firm engaged by the Auditor for this purpose on a contingent fee basis.

Several assignments were nearing completion at month-end, including one consulting contract audit and a review of District-incurred costs pertaining to the Eastside Reservoir Project. Reviews of the special \$70 million distribution to member agencies; the processes used to control and account for bulk fuels; and the District's new Water Information System were among the many assignments in progress at month-end.

Administrative matters handled in February included support for the Special Audit Committee's February 18 meeting and development of the department's 1997-98 operating budget. Participation in various management meetings involved, among other things: litigation support, control self-assessment implementation, the Business Development Program, and contract management. Finally, the Audit Department's services brochure was updated during February. This brochure, which was originally developed in May 1993, was distributed to all directors and employees at that time and all new directors and employees subsequently. The revised brochure is attached to this letter for information purposes.

Attachment

ACTIVITIES IN PROGRESS

Financial Audits			
Assignment Name	Description	Status or Estimated Completion	Significant Events
Quarterly and Year-end Audits - FY 1996-97	Assist KPMG Peat Marwick in quarterly audits of interim cash basis financial statements and year-end audit of accrual basis financial statements for fiscal year 1996-97	Assigned staff completed their assistance to KPMG on the cash basis statements for the six months ended December 31, 1996.	The Auditor transmitted the audited cash basis financial statements to the Board of Directors in February.
Quarterly Lobbying Reports	Review lobbying reports filed with the state quarterly and with the federal government semi-annually for accuracy and compliance.	Reviews of the federal and state lobbying reports for the period ended December 31, 1996, were completed with no exceptions noted.	
Annual Inventory of Central Stores	Monitor and evaluate the overall accuracy of Central Stores warehouse inventories; review and assess the recording of inventory adjustments	Audit staff participated in preliminary Central Stores test counts in preparation for the physical inventories scheduled for mid-March.	
Utility Bills Audits -- Electrical Power and Regular Telephone	Perform testing of utility bills (electrical power/telephones) to ensure accuracy and propriety of billings.	The Auditor engaged a firm which specializes in utility billing audits to examine electrical power and regular telephone billings on a contingent fee basis. Planning work to support the contract audit firm commenced.	
Minor Financial Reviews and Contingencies	Perform miscellaneous reviews of financial areas whenever required in the circumstances.	Continuing assignment. A review of the special \$70 million distribution to member agencies commenced during the month.	

Internal Controls/Compliance Reviews			
Assignment Name	Description	Status or Estimated Completion	Significant Events
Overall Internal Control Assessment Project	Evaluate District's internal control environment in light of framework recommendations contained in COSO Report (Treadway Commission Recommendations Response).	The Auditor and audit met with management and consultants to discuss the planned implementation of a Control Self-Assessment process at the District.	

ACTIVITIES IN PROGRESS

Contract Audits/Vendor Reviews			
Assignment Name	Description	Status or Estimated Completion	Significant Events
Monitor Inland Feeder Project	Monitor contract costs and controls over construction activities related to the Inland Feeder Project.	Preliminary planning and survey procedures pertaining to a review of Agreement No. 4532 with Bechtel Corp. were concluded and detailed testing commenced.	
Consulting Agreement Audits	Develop an ongoing plan for ongoing audits of consulting service agreements; conduct selected agreement audits.	Completion of the review of Agreement No. 3624 with Fay Tech Services has been delayed pending receipt of data requested from Engineering Division staff. Completion is now targeted for March.	
Monitor Eastside Reservoir Project	Document controls over Eastside Reservoir Project (ERP); develop plan to ensure adequate audit coverage of ERP in future years; perform audits of selected ERP contracts.	Detailed testing was substantially completed on a review of District incurred costs (labor, materials, incidentals) pertaining to the Eastside Reservoir Project. This assignment is expected to be completed in March.	

Operational Audits/Program Reviews			
Assignment Name	Description	Status or Estimated Completion	Significant Events
Monitor Ultra Low Flush Rebate Toilet Programs	Review status of Ultra-Low-Flow program by reviewing compliance with related agreements and evaluating program controls.	Detailed testing on this long-deferred assignment commenced during the month.	
Bulk Fuels Usage and Accounting	Review controls over the recording and reporting of fuel usage at various District facilities	Detailed testing was substantially completed and this assignment is expected to be completed in March.	
Overhead Methods Review	Review and assess the propriety and accuracy of District overhead policies and procedures.	The Assistant Auditor met with the District's consultants to provide Audit Department input to the new District indirect cost (overhead) plan currently under development by the Finance and Business Services Division.	

ACTIVITIES IN PROGRESS

Operational Audits/Program Reviews			
Assignment Name	Description	Status or Estimated Completion	Significant Events
Owner-Controlled Insurance Program -- ERP	Monitor administrative controls and financial cost/benefit information related to new owner-controlled insurance program for Eastside Reservoir Project.	The Auditor and staff met with representatives from Deloitte & Touche, LLP and the administrator of the District's contract for ERP-OCIP Broker/Administrator Services to discuss the proposed scope of an audit of that contract.	

Information Systems Audits			
Assignment Name	Description	Status or Estimated Completion	Significant Events
Electronic Messaging Implementation -- SDLC Review	Monitor the implementation of the new Electronic Messaging system as specified in the project plans.	Security, audit and control features of the new E-mail software were evaluated by an information systems auditor.	
Post Implementation Review of People Soft Human Resources Management System	Perform post-implementation testing to ensure that controls are adequate and output is authorized, complete, accurate, secure and reliable.	This assignment was completed and a summary report was distributed to management for its consideration.	
Post Implementation Review of the Water Information System (WINS)	Perform post-implementation testing to ensure that controls are adequate and output is authorized, complete, accurate, secure and reliable.	Preliminary audit field work commenced on this assignment during the month.	
Minor EDP Assignments	Perform miscellaneous information systems reviews whenever required.	Continuing assignment.	

ACTIVITIES IN PROGRESS

Other			
Assignment Name	Description	Status or Estimated Completion	Significant Events
Administrative Assistance to Board/Management/ Staff	Provide advice and assistance to the Board, management or staff, and participate in meetings or other activities as required.	Continuing assignments include Board and Committee Activities, Executive Council and Operating & Organizational Review Committee participation. Also includes participation in the Information Technology Committee, the Steering Committee for Policies and Procedures of Consulting and Professional Services Agreements and assistance to the Legal Department pertaining to the District's litigation with CTSI Corp.	
Special Audit Committee Support	Provide administrative and logistical support to the Special Audit Committee as necessary, including preparation for and participation in all Committee meetings	Support for the Committee's February 18, 1997, meeting was provided during the month.	
Monitor Risk Management Activities	Monitor Risk Management Office activities and coordinate audit efforts accordingly.	The staff member assigned to this job attended a quarterly meeting with the District's workers compensation claims administrator.	
Business Resumption Task Force	Participate in the development and implementation of a District-wide comprehensive Business Resumption Plan for responding to natural disasters or other emergency situations.	An audit staff coordinator participated in an informational meeting concerning the Business Resumption Plan.	
Monthly Cash Counts / Payroll Check Disbursements	Test a sampling of payroll check disbursements at various locations; review and test selected petty cash funds to ensure controls are adequate and funds are completely and accurately recorded.	Payroll checks and auto-deposit stubs were distributed to selected employees at Gene Camp and at the Diemer Filtration Plant. Petty cash funds were also tested at both facilities. No exceptions were noted during this testing.	
Surname or Review Contracts	Review drafts of contracts, certain Board letters and other relevant matters prior to their completion.	Continuing assignment.	

POTENTIAL BENEFITS OF AUDITS

In addition to identifying errors in accounting records or verifying the accuracy of financial reports, internal audits also provide a number of other potential benefits, such as the following:

- Provide objective assessments of areas of interest or concern to the Board and management.
- Help determine whether internal controls and procedures are satisfactory or are in need of improvement.
- Help identify deviations from Board policies or management's standards and expectations.
- Recommend improvements to systems of accounting and administrative controls to detect or prevent problems.
- Help identify potential productivity enhancements, including opportunities to improve on outdated or ineffective procedures.
- Assist in the development of computerized information systems to enhance their integrity, security and auditability.
- Help identify underbilled revenues or potential additional revenues.
- Help identify contractor or vendor overcharges.
- Assist in the early detection of conditions which may result in serious problems if not corrected.

THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

District Mission Statement

The mission of the Metropolitan Water District of Southern California is to provide its service area with adequate and reliable supplies of high quality water to meet present and future needs in an environmentally and economically responsible way.

Audit Department Mission Statement

The mission of the Audit Department of the Metropolitan Water District of Southern California is to support the organization's mission and goals by providing quality internal auditing services to the Board, management and staff consistent with the Board's Internal Audit Goal.

Department of the Auditor

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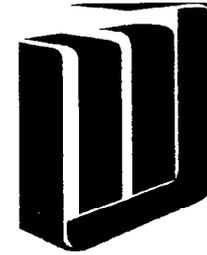
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The Audit Department has established a home page on the District's Internet web site. Information about the department on the Home Page includes a Table of Organization, the Audit Department Charter and Administrative Code Sections, and Audit Work Plan summaries for the current fiscal year. This Home Page can be accessed at the following address:

<http://www.mwd.dst.ca.us/audit>

(February 1997)

MWD



Department of the Auditor

INTERNAL AUDIT

an Introduction

The purpose of this brochure is to introduce you to the Metropolitan Water District Audit Department.

It explains why the internal audit function exists, how audit areas are selected, the audit process, and the potential benefits which result from audits.

WHY ARE WE HERE?

The Audit Department has been established by the MWD Board of Directors to provide an independent perspective on, among other things, internal controls and asset safeguards, operations and programs, and financial matters. The Board has adopted the following internal audit goal:

"MWD will maintain an internal audit function to ensure that MWD's systems of internal controls are adequate; that bond covenants, organizational policies, and applicable laws and regulations are complied with; that assets and resources are properly accounted for and safeguarded against waste, loss, or misuse; and that financial systems and reports are accurate and reliable."

The District's Auditor is appointed by the Board of Directors and reports through a Special Audit Committee. A formal Charter which outlines the purpose, authority and principal responsibilities of the Audit Department was approved by the Board in 1995.

While perceptions of an audit function are sometimes negative, we strive to assist managers and staff whenever possible. Our services are designed to aid management in establishing internal controls which are adequate and cost-effective, and to promote accountability and compliance with policies and procedures, as well as efficient business practices.

Our internal audit activities are governed by provisions of the MWD's Administrative Code, as well as the California Government Code. The government code requires compliance with the "Standards for the Professional Practice of Internal Auditing," as set forth by the Institute of Internal Auditors. The *Standards* provide guidance in the nature, scope, performance and management of the audit function.

WHAT DO WE AUDIT?

Each year, the Audit Department prepares a detailed Audit Work Plan which identifies our planned audit activities by specific assignment in one of six general categories. The Audit Work Plan typically includes financial and compliance audits, information systems reviews, and operational or other assessments, including those requested by the Board or management. We also assist Metropolitan's external auditors in their periodic audits of the District's financial statements. In addition to planned audit activities, a limited number of hours are budgeted each year for unanticipated audit requirements and Board or management requests during the year.

The work plan is a dynamic document which evolves from an ongoing assessment of financial risk considerations, the public/regulatory impact of various District activities, and the concerns of directors, management and others. Copies of the work plan are periodically provided to all Board members, via the Special Audit Committee, for their information.

THE AUDIT PROCESS

1. Audit Selection

In addition to audits performed by necessity or to comply with Board policy, other areas are reviewed on a discretionary basis. However, since the Audit Department's resources are not sufficient to audit all areas of interest or concern or, for that matter, all aspects of each area selected for audit, risk assessment is used to select and prioritize our work. Management's needs or requests are also considered and incorporated into the scope of our work if feasible. Since we have limited time available, audits are often confined to key areas which are perceived to represent areas of high risk and/or high potential payback.

2. Preliminary Survey and Planning

Once a decision has been made to audit an area, we gather background data such as program or District objectives, organizational charts, established administrative policies and procedures and performance indicators. In most cases, an entrance meeting will be held with affected managers to review the general objectives of the audit. Management is afforded an opportunity at this time to provide input as to their concerns and to identify areas that they would like to have reviewed.

3. Fieldwork

Once the key areas of concern have been identified, we develop an audit program to address the specific steps to be performed by the auditors. The audit objectives and scope of coverage are reviewed and approved by the Auditor or the Assistant Auditor prior to the inception of field work. The timetable for subsequent completion of the audit fieldwork will vary based upon the size of the program or concurrent projects. We encourage managers to ask about the audit progress if more timely information is desired.

4. Reporting

All audit concerns are communicated either verbally or in writing to affected staff and management throughout the audit. Many of the issues identified are resolved prior to completion of our field work, or are not significant enough to require formal audit reports to management. However, the more significant issues will be included in the audit reports which are prepared at the conclusion of our larger assignments. District staff are given an opportunity to review and respond to draft reports prior to the issuance of the final reports. Summary level audit reports are provided to the Board, via the Special Audit Committee, after we have received and evaluated management's response to the final audit reports.