

(SEE REVISED LETTER DATED 10-6-95)

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METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

September 20, 1995

To: Board of Directors (Executive Committee--Action)
From: Chair, Special Audit Committee
Subject: Audit Department Charter and Administrative Code Revisions

Recommendation

It is recommended that the Board of Directors approve the Audit Department Charter contained at Attachment A to this letter, and amendments to Administrative Code Section 6450 as set forth in Attachment B.

Detailed Report

At its meeting on September 19, 1995, the Special Audit Committee considered letters of the General Manager, dated August 29, 1995, the Auditor, dated August 31, 1995, and a memorandum from the committee Chair, dated September 15, 1995, concerning the role of the District's Auditor, including his organizational reporting structure, his authority and responsibilities, and the practices for reporting the results of his department's work efforts. The committee further considered remarks by the General Manager, Auditor, and Chair on these subjects prior to entertaining a motion by Director Hill, seconded by Director Griffen, which recommended:

1. That no changes be made at this time in the organizational reporting structure pertaining to the Internal Auditor; and
2. That the Audit Department Charter as recommended by the Internal Auditor and QAR, and as previously adopted by the SAC, be ratified and approved for transmittal and adoption by the Board of Directors, along with the necessary Administrative Code changes as set forth by the Auditor.

After further discussion, the committee approved these recommendations with one dissenting vote, although approval of the proposed Administrative Code changes was made subject to further review by the General Counsel to ensure that the changes are in conformity to the aforementioned Audit Department Charter document and current audit report

September 20, 1995

distribution practices. Subsequently, the General Counsel advised me that the proposed changes to Administrative Code Section 6450 as set forth in Attachment B conform to the Audit Department Charter and existing reporting practices. A copy of Section 6450, as amended, is contained at Attachment C.

As many Board members are aware, the Special Audit Committee has, over the course of the last year, devoted much energy and time to examining the role of the Special Audit Committee and the District's Auditor. In this regard, the committee has conducted workshops and made available to the directors a number of aids, including--among many other things--a publication by the Institute of Internal Auditors, The Audit Committee: A Briefing on Roles and Responsibilities; a Quality Assurance Review of the Audit Department, as of March 1995, by the Institute of Internal Auditors ("the QAR"); and an Internal Audit Department Peer Comparison Report by the District's external auditor, KPMG Peat Marwick, dated April 7, 1995.

Based on these materials and workshop discussions, the committee has determined that the District's current organization reporting structure for the Internal Auditor should not be changed at this time. In addition, as part of the committee's work to approve a final annual Audit Work Plan for the 1995-96 year, I have established a committee workgroup consisting of myself, Committee Vice-Chair Milne, and members Handelman and Huntley. This workgroup will be meeting with Management and Audit Department staff to receive a detailed report and make recommendations to ensure that the District is achieving the necessary scope of audit as described in the QAR.



Christine M. Frahm

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Attachments

ATTACHMENT A

The Metropolitan Water District of Southern California

AUDIT DEPARTMENT CHARTER

This Charter describes the purpose, authority, and principal responsibilities of the District's Audit Department.

PURPOSE

Internal auditing is an independent appraisal activity established by the Board of Directors to assist in fulfilling the District's Mission and the Board's Internal Audit Goal. Internal auditing is an integral element of the District's systems of internal control through its examinations and evaluations of the adequacy and effectiveness of the organization's other administrative and accounting controls.

A primary objective of internal auditing is to assist members of the organization in the effective discharge of their responsibilities. To this end, internal auditing furnishes them with analyses, appraisals, recommendations, counsel, and information concerning the activities audited or reviewed. Another major objective of internal auditing is to promote the establishment and maintenance of effective internal controls at reasonable cost.

AUTHORITY

Internal auditing is governed by policies established by the Board of Directors. The scope of internal auditing activities is subject to Board review and approval, but shall not otherwise be restricted. The Board's Special Audit Committee is responsible for the oversight of the internal auditing function and for reviewing all reports issued by both the internal and external auditors.

For internal auditing to be effective, it is essential that management cooperate fully with its efforts. Internal auditors, with stringent regard for safekeeping and confidentiality, shall have unlimited accessibility to all District activities, records, property, and employees as may be necessary to carry out their assigned responsibilities.

Internal auditing is a staff function and internal auditors have no authority over, or responsibility for, the activities they audit.

RESPONSIBILITIES

Internal auditing responsibilities include, but are not limited to:

- o Examining and evaluating the adequacy and effectiveness of the organization's systems of internal control, including those pertaining to the deterrence, detection, and investigation of fraudulent or illegal acts.
- o Reviewing the reliability and integrity of financial and operating information and the means used to identify, measure, classify, and report such information.

ATTACHMENT A

The Metropolitan Water District of Southern California

AUDIT DEPARTMENT CHARTER (Continued)

RESPONSIBILITIES (Continued)

- o Reviewing the systems established to ensure compliance with those policies, plans, procedures, laws, and regulations which could have a significant impact on operations and reports, and determining whether the organization is in compliance.
- o Reviewing the means of safeguarding assets and, as appropriate, verifying the existence of such assets.
- o Appraising the economy and efficiency with which resources are employed and the quality of performance in carrying out assigned responsibilities.
- o Reviewing operations or programs to ascertain whether results are consistent with established objectives and goals and whether the operations or programs are being carried out as planned.
- o Coordinating internal auditing activities with the work of the independent external auditors and assisting the external auditors as required.

In meeting its responsibilities, internal auditing activities are to be conducted in accordance with District strategic objectives and established policies and procedures. In addition, internal auditors shall comply with the Code of Ethics and the Standards for the Professional Practice of Internal Auditing promulgated by The Institute of Internal Auditors, Inc., as well as other professional auditing standards which may be applicable to the performance of their work assignments.

The performance of non-auditing related functions by internal auditors may compromise their objectivity about current or future review areas; accordingly, internal auditors will not perform such other duties in normal circumstances.

References:

- o Sections 2560-2561 and 6450-6451 of the MWD Administrative Code.
- o California Government Code Section 1236.
- o Various MWD Administrative Code Sections, General Instructions, Management Bulletins, and Management Memorandums, as applicable.
- o MWD Mission Statement, Board Goals, and Strategic Plan.
- o The Standards for the Professional Practice of Internal Auditing (IIA).
- o General Standards for Information Systems Auditors (EDPAA).
- o U.S. Auditing Standards (AICPA).
- o Government Auditing Standards (USGAO).
- o MWD Audit Department Policies and Procedures Manual.

ATTACHMENT B

§ 6450. Powers and Duties.

~~— (a) The Auditor shall review and appraise the soundness, adequacy and application of accounting and financial reporting systems and controls; ascertain the extent to which District assets are accounted for and safeguarded from losses; ascertain the reliability of the financial statements; and determine compliance with bond covenants, applicable laws and regulations and orders of the Board. He shall carry out such duties by periodic examinations of financial statements or segments of financial statements, or both, and of accounting and financial systems and controls and tangible goods and controls, as he deems necessary and proper.~~

§ 6450. Powers and Duties.

(a) The District's independent internal auditing function is governed by provisions of the California Government Code and by policies established by the Board of Directors. The scope of internal auditing activities is subject to Board review and approval, but shall not otherwise be restricted. The Special Audit Committee is responsible for the oversight of the internal auditing function and for reviewing reports issued by both the internal and external auditors. Internal auditors, with stringent regard for safekeeping and confidentiality, shall have access to all District activities, records, property, and employees as may be necessary to carry out their assigned responsibilities.

(b) The Auditor manages the District's Audit Department and is responsible to perform, among other things, the following duties as he deems necessary and proper:

- (1) Examining and evaluating the adequacy and effectiveness of the organization's systems of internal control, including those pertaining to the deterrence, detection, and investigation of fraudulent or illegal acts.
- (2) Reviewing the reliability and integrity of financial and operating information and the means used to identify, measure, classify, and report such information.
- (3) Reviewing the systems established to ensure compliance with those policies, plans, procedures, laws, and regulations which could have a significant impact on operations and reports, and determining whether the organization is in compliance.
- (4) Reviewing the means of safeguarding assets and, as appropriate, verifying the existence of such assets.

(5) Appraising the economy and efficiency with which resources are employed and the quality of performance in carrying out assigned responsibilities.

(6) Reviewing operations or programs to ascertain whether results are consistent with established objectives and goals and whether the operations or programs are being carried out as planned.

(7) Coordinating internal auditing activities with the work of the independent external auditors and assisting the external auditors as required.

(c) In addition to the duties outlined at paragraph 6450(b), the Auditor is responsible for formulating departmental policies and procedures; directing and evaluating the performance of work done by employees within the department; developing an annual work plan in conjunction with the other executive offices; administering the internal records of the department; and administering the District's contract for external audit services.

(d) The Auditor shall report the findings, opinions, and recommendations which result from the performance of the duties outlined in paragraphs 6450(b) and (c) to the General Manager and General Counsel for their information and appropriate actions. The form and content of such reports shall be determined by the Auditor based on the results obtained and other circumstances. Whenever an audit report contains recommendations for corrective actions or changes in current practices, the General Manager, the General Counsel, or their designees shall respond to the Auditor in an appropriate manner and within a reasonable time, indicating their views on the recommendations and proposed actions to be taken, if any. The Auditor shall then submit a summary or detailed report on major assignments conducted, or significant issues noted, to the Special Audit Committee.

(e) Except for the Auditor's monthly Audit Department activity reports addressed to the entire Board, and as outlined in paragraph 6450(d), the Auditor's reports on internal audit assignments shall be addressed to the Special Audit Committee. The Auditor shall have the — (b) The Auditor shall report to the Board through the Special Audit Committee his findings, opinions and recommendations arising from his performance of the duties assigned by Section 6450(a). Except when such reports are deemed by him to be urgent or confidential, they discretion to determine the form and content of such audit reports, subject to guidance or direction by the Special Audit Committee. With the exception of those reports which the Auditor deems to be urgent or confidential in nature, copies of all audit reports addressed to the Special Audit Committee shall be submitted to the General Manager and General Counsel for their review prior to review and comment prior to their submittal to the Special Audit Committee.

(e) The Auditor shall perform such special audits and examinations as are approved by the Board upon joint recommendation of the Special Audit Committee and the standing

~~committee concerned with the subject matter of the proposed special audits and examinations. Upon completion of a special audit or examination, he shall file a report thereon with the Special Audit Committee and such standing committee and send copies thereof to the General Manager and the General Counsel. He shall also perform such special audits and examinations as may be requested by the General Manager or the General Counsel upon approval by the Board.~~

~~— (d) The Auditor shall direct the performance of work done by employees within his department.~~

~~— (e) The Auditor shall assist external auditors retained by the Board.~~

(f) The Auditor shall transmit all reports issued by the District's external auditors to the Special Audit Committee and any other committees of the Board as may be applicable. Such transmittal letters should include any comments on the external auditor's reports that the Auditor deems necessary.

(g) The Auditor may receive requests from time to time from the other executive officers or committees of the Board to perform audit assignments which are not included in the approved annual Audit Work Plan. Similarly, the Auditor may identify a need to include new priority assignments in the Audit Work Plan during the year. The Auditor shall have sufficient latitude and discretion to include those new assignments in the annual Audit Work Plan as he deems necessary and to make other revisions as are warranted in the circumstances. All revisions to the Audit Work Plan will be communicated periodically to the Special Audit Committee for its information and concurrence. The reporting process for assignments requested by either executive management or by committees of the Board shall generally follow the process outlined in paragraphs 6450(d) or (e) previously. However, any reports on audits requested by a committee of the Board shall be jointly addressed to such committee and the Special Audit Committee. Copies of these reports will first be provided to management for review and comment consistent with the provisions of paragraph 6450(e).

ATTACHMENT C

§ 6450. Powers and Duties.

(a) The District's independent internal auditing function is governed by provisions of the California Government Code and by policies established by the Board of Directors. The scope of internal auditing activities is subject to Board review and approval, but shall not otherwise be restricted. The Special Audit Committee is responsible for the oversight of the internal auditing function and for reviewing reports issued by both the internal and external auditors. Internal auditors, with stringent regard for safekeeping and confidentiality, shall have access to all District activities, records, property, and employees as may be necessary to carry out their assigned responsibilities.

(b) The Auditor manages the District's Audit Department and is responsible to perform, among other things, the following duties as he deems necessary and proper:

- (1) Examining and evaluating the adequacy and effectiveness of the organization's systems of internal control, including those pertaining to the deterrence, detection, and investigation of fraudulent or illegal acts.
- (2) Reviewing the reliability and integrity of financial and operating information and the means used to identify, measure, classify, and report such information.
- (3) Reviewing the systems established to ensure compliance with those policies, plans, procedures, laws, and regulations which could have a significant impact on operations and reports, and determining whether the organization is in compliance.
- (4) Reviewing the means of safeguarding assets and, as appropriate, verifying the existence of such assets.
- (5) Appraising the economy and efficiency with which resources are employed and the quality of performance in carrying out assigned responsibilities.

(6) Reviewing operations or programs to ascertain whether results are consistent with established objectives and goals and whether the operations or programs are being carried out as planned.

(7) Coordinating internal auditing activities with the work of the independent external auditors and assisting the external auditors as required.

(c) In addition to the duties outlined at paragraph 6450(b), the Auditor is responsible for formulating departmental policies and procedures; directing and evaluating the performance of work done by employees within the department; developing an annual work plan in conjunction with the other executive offices; administering the internal records of the department; and administering the District's contract for external audit services.

(d) The Auditor shall report the findings, opinions, and recommendations which result from the performance of the duties outlined in paragraphs 6450(b) and (c) to the General Manager and General Counsel for their information and appropriate actions. The form and content of such reports shall be determined by the Auditor based on the results obtained and other circumstances. Whenever an audit report contains recommendations for corrective actions or changes in current practices, the General Manager, the General Counsel, or their designees shall respond to the Auditor in an appropriate manner and within a reasonable time, indicating their views on the recommendations and proposed actions to be taken, if any. The Auditor shall then submit a summary or detailed report on major assignments conducted, or significant issues noted, to the Special Audit Committee.

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