

- **Internal Audit Report for September 2005**

Summary

Three Audit Reports were issued during the month of September 2005:

- **Water Quality Audit Report** – Issued with a Satisfactory opinion
 - **Hazardous Waste Management Audit Report** - Issued with a Less Than Satisfactory opinion
 - **Business Continuity Audit Report** – Issued with a Less Than Satisfactory opinion
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Discussion Section

This report highlights the significant activities of the Internal Audit Department during September 2005. In addition to presenting background information and the opinions expressed in the audit reports, a discussion of findings noted during the reviews is presented.

Water Quality Audit Report

Background

The Interim Enhanced Surface Water Treatment Rule, Stage 1 Disinfectants/Disinfection By-Products Rule, Total Coliform Rule, and California's Title 22 list of Maximum Contaminant Levels establish drinking water standards. Metropolitan's Water Quality standard operating procedures and quality assurance manuals establish laboratory and administrative practices to ensure compliance with these federal and state drinking water regulations. In addition, ELAP certification signifies that Metropolitan's Water Quality Laboratory and contract laboratories utilized by Metropolitan to monitor and report contaminants have demonstrated capability to analyze environmental samples using approved methods.

The Water Quality Laboratory, within the Water System Operations Group's (WSO) Water Quality Section, is responsible for monitoring and analyzing water samples from Metropolitan's source water reservoirs, treatment facilities and distribution system to ensure that water quality meets or exceeds regulatory standards. In addition, they document the results of these tests, prepare required regulatory reports, and maintain associated documentation.

Opinion

In our opinion, the operating and administrative procedures over Water Quality include those practices usually necessary to provide for a satisfactory internal control structure. The degree of compliance with such procedures provided effective control for the period January 1, 2004 through June 30, 2005.

Comments and Recommendations

Minor comments were noted in the areas of inconsistent plant laboratory records; self-monitoring process for water treatment and distribution operator certifications; and inconsistent maintenance and inspection documentation on floating reservoir covers.

Management Response

WSO management has provided adequate responses to these comments.

Hazardous Waste Management Audit Report

Background

Metropolitan purchases and stores various chemicals and materials for use in its daily operations. Once used or spent, the California Code of Regulations categorizes many of these chemicals as “hazardous waste” because of their potential hazard or risk to human health or the environment. The accumulation, handling, transporting, and disposal of hazardous waste are regulated by federal, state, and local agencies (e.g., U.S. Environmental Protection Agency, Department of Toxic Substances Control (DTSC), and the Department of Transportation). These agencies have enacted strict regulations for the control over hazardous waste, including spills.

The Environmental Support Services Unit (ESS), of the Water System Operations Group, administers Metropolitan’s vendor contracts for waste removal activities (both hazardous and designated industrial wastes) including transportation and disposal and pays all related disposal charges, fees and taxes. ESS activities also include hazardous waste identification, analysis, handling, storage, recycling, and waste minimization efforts as mandated by the DTSC. ESS also performs hazardous waste manifesting, exception reporting, and related recordkeeping requirements concerning hazardous waste generation and hazardous waste minimization efforts. Further, ESS provides training assistance to managers, supervisors, and field personnel on proper hazardous waste management procedures. Topics include: hazardous waste identification, storage and labeling of waste containers, and recycling, waste minimization and disposal requirements.

Opinion

In our opinion, the accounting and administrative procedures over the Hazardous Waste Management Program provide for a less than satisfactory internal control structure. This opinion is solely the result of improper contract administration over hazardous waste services agreements. Specifically, we noted a lack of review and approval controls over invoice processing resulting in incorrect and unsupported charges to Metropolitan. Our review did not, however, include an evaluation of the compliance with hazardous waste regulatory requirements and, accordingly, we do not express an opinion as to these matters.

Comments and Recommendations

As noted in the opinion, our audit revealed weaknesses in the review and approval controls over invoice processing. These controls are designed to verify the accuracy of billings for services, provide assurance as to the propriety of transactions, and ensure that follow-up procedures for

exceptions exist. For the hazardous waste services agreements, ESS should review expenditures listed on the vendor invoices for propriety and agree them to the source documents to ensure the accuracy and completeness of transactions.

Our examination included a review of 55 invoices received from three vendors during the period January 1 through December 31, 2004. This review included all invoices greater than \$7,000 and totaled \$621,532 (or 45%) of the \$1,371,053 of invoices received and paid during this period. These invoices were from the three vendors providing hazardous waste services to Metropolitan: United Storm Water, Inc.; Consolidated Waste Industries, Inc.; and General Environmental Management, Inc.

Specifically, with regard to review and approval controls, we found numerous discrepancies between the invoice and the contractual terms of the agreement or between the invoice and supporting documentation. For example, we noted that 40 of the 55 invoices examined included items billed at rates other than contract rates; we identified inappropriate markups applied to subcontractor costs; treatment, storage and disposal facility costs were included on the invoices without supporting documentation; and we noted miscellaneous charges included without a description or supporting documentation. In addition, we noted quantity discrepancies on waste disposal activities between Metropolitan's manifest and the vendor's invoice. These discrepancies revealed overpayments totaling \$6,100, however, supporting documentation for 23 invoices could not be obtained from the vendor and, therefore, we were unable to quantify potential errors on these invoices. Our review also revealed that all invoices were signature approved by the ESS unit but noted that their review was a cursory review at best.

Our review also revealed areas of noncompliance with the terms and conditions of the agreement. Specifically, we noted that although the vendor agreements require an approved work order for services performed, we cited eight of the 55 invoices reviewed either did not have an approved work authorization attached or a district employee did not approve the attached work authorization. Furthermore, the General Environment Management (GEM) agreement includes a 1% discount on payments made within 21 days of receipt of the invoice; however, we noted no invoices that included this discount. The lost discount is \$8,300 on total billings from inception of the agreement through February 28, 2005. Finally, the Consolidated Waste Industries agreement includes a 2% discount on payments made within 30 days of receipt of the invoice; however, we noted no invoices that included this discount. The lost discount is \$15,500 on total billings from inception of the agreement through February 28, 2005.

We recommended that ESS management establish procedures to ensure that all hazardous waste invoices are reviewed for compliance with contractual terms. We further recommended that ESS management request a refund for all excess billings identified. Finally, we recommended that the ESS management conduct periodic reviews of invoices paid to ensure proper review and compliance with the terms and conditions of the agreements.

Management Response

Metropolitan's Environmental Support Services Management has adequately responded to these concerns. This response included re-bidding the hazardous waste service contracts with revised provisions; strengthening review controls by requiring Team Manager signature approval on

invoices over \$10,000; and by partnering with Purchasing to receive assistance for the review of these invoices.

Business Continuity Plan Audit Report

Background

Business continuity planning continually confronts the unlikelihood of a disaster or an unexpected service interruption. It is a proactive, executive commanded crisis management program driven by business requirements. The Business Continuity Plan (BCP) creates a crisis management team empowered to control any business disruption from interruptions in the water distribution system to and including a worst-case scenario involving complete inaccessibility of facilities. As a proactive management controlled program, BCP mitigates the consequences of a business interruption to a level acceptable to management and provides a tested vehicle that when executed will permit an effective resumption of interrupted business functions. Metropolitan's BCP is the responsibility of the Security and Emergency Management Unit of the Water System Operations Group.

Opinion

In our opinion, the administrative practices and procedures over the Business Continuity Plan provide for a less than satisfactory internal control structure. This opinion is the result of concerns related to incomplete documentation as well as inadequate testing of the BCP.

Comments and Recommendations

Business Continuity Plan documentation identifies business units and functions, policies and procedures, and provides action plans and escalation processes necessary to recover critical functions in the event of a disaster or other unplanned service disruption. The BCP is necessary to minimize the operational and financial impacts of an emergency and should be designed to: 1) safeguard District employees, property and facilities; 2) evaluate the business disruption and initiate the appropriate actions; 3) recover and resume operations in a timely manner; 4) protect the books and records; and 5) initiate effective communications between the district, its employees and the public. The Business Continuity Team is led by the Business Continuity Manager and is made up of the Business Incident Command Center Commander and representatives from WSO, IT, CFO and Public Affairs. The BCP should be developed, approved, and distributed to all Business Continuity Team members.

Our audit revealed that, as of April 29, 2005, a thorough BCP was not fully documented. Furthermore, although we note that on July 11, 2005 version 2.0 of the BCP was distributed to the Business Continuity Team we believe that this version does not satisfy the documentation requirements of a well-developed BCP.

Specifically, we noted that the BCP was incomplete as the Information Technology Recovery procedures were not included in the BCP documentation (these procedures were published in late September 2005). Further, procedures for business processing recovery or manual procedures

were not included in the BCP. For example, procedures were not included for payment processing, accounts receivables/payables, procurement, contract administration, and treasury/debt management processes, among others. In addition, we noted that relocation strategies for employees to move to pre-identified field locations and that planning issues for preparing facilities to receive employees during disasters were not documented. Finally, we noted that procedures for leasing space in non-owned facilities and BCP budget and tracking procedures were not documented.

We recommended that the Business Continuity Manager establish an action plan to address the incomplete areas. We also recommended that the Business Continuity Manager follow up with Information Technology to ensure that the IT Disaster Recovery procedures are included as part of the BCP. Further, we recommended that the Business Continuity Manager update the BIA. Finally, we recommended that Executive management annually review and approve the BCP.

With regard to Business Continuity Plan Testing, we noted that exercises, simulations, and full operational exercises were not performed were not completed. We did note that several tabletop exercises were developed and executed, although we noted that these exercises covered limited functions. We recommended that the Business Continuity Manager prepare a detailed testing plan and schedule for BCP. In addition, we recommended that the testing, based on a revised and approved BCP, be performed as soon as possible.

Management Response

Executive management is preparing a detailed response to these audit comments.