

- **Internal Audit Report for June 2006**

Summary

Four audit reports were issued during the month:

- **Other Income and Expense Audit Report – Satisfactory**
 - **Transit Reimbursement Program Audit Report – Satisfactory**
 - **Records Management Program Audit Report – Generally Satisfactory**
 - **Johnson Controls, Incorporated Audit Report - Satisfactory**
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Discussion Section

This report highlights the significant activities of the Internal Audit Department during June 2006. In addition to presenting background information and the opinion expressed in the audit report, a discussion of findings noted during the examination is presented.

Other Income and Expense Audit Report

Background

Other Income and Expense is a component of Metropolitan's annual Statements of Revenues, Expenses and Changes in Net Assets and monthly Statement of Operations. Other income items include annexation charges, property rentals, gain on land sales, earnings on escrow accounts, and sundry revenue. Other expense items include arbitrage rebate tax, research and development, and sundry expense. The Other Income and Expense accounts resulted in net other income of \$5.7 million (\$7.4 million in income and \$1.7 million in expenses) for the ten-month period ending April 30, 2006.

Opinion

In our opinion, the accounting and administrative procedures over Other Income and Expense 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 July 1, 2005 through April 30, 2006.

Comments and Recommendations

There were no material findings to report.

Transit Reimbursement Program Audit Report

Background

Metropolitan provides a maximum \$125 per month benefit to its employees in a transit voucher for commuting to work by bus, commuter train or light rail. This Program requires employees to ride a minimum of three days a week or twelve days a month to be entitled for the transit voucher.

During the review period, Metropolitan's monthly average transit expense was \$45,598 and the number of monthly average participants was 434. Agency temporary, consultants, and contractors accounted for \$3,827 of the monthly average transit expense and 43 of the monthly average participants.

Opinion

In our opinion, the accounting and administrative procedures over the Transit Reimbursement Program include those practices usually necessary to provide for a satisfactory internal control structure. The degree of compliance with such policies and procedures provided effective control for the period January 1, 2005 through April 30, 2006.

Comments and Recommendations

COMPLIANCE WITH ESTABLISHED POLICIES AND PROCEDURES

MOUs between Metropolitan and MAPA, Supervisors' Association, ACE and AFSCME specify that employees may be eligible for rideshare reimbursement up to \$125 per month. In addition, the Transit Procedures require rideshare transit participants to meet certain requirements to be eligible to claim a transit voucher.

During our review, we noted that MOUs define the term employee as an individual on the District's payroll in a regular full-time, regular part-time, temporary full-time, temporary part-time or recurrent position. However, we noted that Metropolitan reimburses agency temporaries, consultants and contractors who are not covered by the MOUs and we could not locate any documentation to support those payments. We also noted other minor instances of non-compliance with established procedures.

We recommend that management review the established policies and procedures, make necessary revisions, emphasize the importance of complying with established policies and procedures, and conduct periodic tests to ensure compliance with these policies and procedures.

Records Management Program Audit Report

Background

The Records Management Program (Program) was established to provide a Metropolitan-wide system to identify vital and historical records, to establish effective preservation techniques, to monitor overall compliance with good records management practices, and to assure proper retention based on government, tax, and legal requirements. The Program consists of an inventory of Metropolitan records and the preparation, implementation, and maintenance of a Records Retention Schedule (RRS). Metropolitan's Administrative Codes, Operating Policy B-03 and B-11, and the Records Management Procedure Manual all specify this Program's policies and procedures. The Records Management Team is responsible for administering the Program and providing assistance and training to Records Coordinators.

As part of the Program, Metropolitan contracted with the Los Angeles Department of Water and Power (DWP) and Iron Mountain off-site Data Protection (Iron Mountain) to provide off-site

storage and related delivery services. During the sixteen-month period ended April 30, 2006, Metropolitan paid approximately \$77,530 and \$70,664 to DWP and Iron Mountain, respectively. As of April 30, 2006, Metropolitan had approximately 20,000 boxes of records and 100,000 hanging drawings at DWP as well as 400 containers of electronic media and 2,700 magnetic tapes at Iron Mountain.

Opinion

In our opinion, the accounting and administrative procedures over the Program include those practices usually necessary to provide for a generally satisfactory internal control structure. The degree of compliance with such policies and procedures provided effective control for the period January 1, 2005 through April 30, 2006. Although this report is issued with an acceptable opinion, concern is expressed in the areas of reconciliations of records management databases and compliance with policies and procedures.

Comments and Recommendations

Specific concerns regarding reconciliations are presented in detail, while other comments are summarized.

RECONCILIATIONS OF RECORDS MANAGEMENT DATABASES

Metropolitan's records management databases are designed to maintain an inventory of all off-site media including a detailed description, retention period, location, classification, and other related information. Contractors' databases maintain tracking numbers for Metropolitan's media and history of delivery activities for billing purposes. Reconciling off-site media per Metropolitan's databases with contractors' databases helps to ensure all off-site media are properly accounted for and verifies the accuracy and completeness of storage billings.

During our review, we could not locate reconciliations of off-site media between Metropolitan's databases and contractors' databases. Specifically, we noted discrepancies between DWP and Metropolitan databases and between Iron Mountain and Metropolitan databases. We understand that these differences are largely the result of delays in entering information into Met's application making periodic reconciliations impractical and problematic.

We recommend that Records Management establish procedures to perform periodic reconciliations of off-site media between Metropolitan's database and contractors' database to ensure consistency and accuracy of records maintained. We also recommend that Records Management establish procedures to ensure that timely update of Metropolitan's databases are completed.

COMPLIANCE WITH ESTABLISHED POLICIES AND PROCEDURES

Metropolitan's Administrative Code (Admin Code), Operating Policy B-03 and B-11, and Records Management Procedure Manual (the Manual) furnish rules, guidelines, and procedures to assist employees in records management.

During our review, we noted that Section 10100 of the Admin Code states, "Records Retention Schedule shall be reviewed at least annually and updated periodically as required or deemed necessary by executive management." We noted that the draft Records Retention Schedule (RRS) was not approved and needs to be updated. In addition, we noted that the existing policies and procedures do not adequately address all media currently used by Metropolitan's employees. It should be noted that Records Management is in the process of implementing a new RRS system.

We recommend that Records Management continue to evaluate the existing policies and procedures and amend them, as necessary to ensure that they provide consistent guidance to employees.

COMPLIANCE WITH TERMS AND CONDITIONS OF AGREEMENTS

We also noted other minor instances of non-compliance to the terms and conditions of agreements. Records Management concurs with these comments and is in the process of addressing these concerns.

Johnson Controls, Incorporated Audit Report

Background

In June 2003, Metropolitan's Board appropriated \$11.243 million to implement district-wide security system improvements (appropriation 15295) and authorized up to \$9.5 million to enter into an agreement with JCI. On September 29, 2003, Metropolitan contracted with JCI to design an integrated security system; furnish and install security equipment and cabling infrastructure; and conduct system tests. The scope of work included alarm, video, and access control improvements at the 63 highest priority sites throughout Metropolitan's conveyance, treatment, and distribution system. These included improvements at the primary and secondary security command centers (Eagle Rock and Diamond Valley Lake respectively) and for a standby server at Union Station.

The JCI contract is capped at \$8.365 million and includes a one-year warranty term for equipment, software, and hardware provided by JCI. The warranty is effective for one year after the security system as a whole has successfully completed all tests and has demonstrated the ability to meet all functional requirements and performance standards (e.g., successfully integrate the JCI Pegasus 2000 access control and the Smart Sight digital security system to Metropolitan's existing IT infrastructure). Metropolitan's Agreement Administrator is currently working with JCI to schedule a date to commence final 30-day operational testing. In addition, JCI has provided documentation and training to Metropolitan's staff and consultants at various facilities (e.g., command centers and Union Station). As of January 31, 2006, Metropolitan has paid approximately \$6.315 million to JCI and retained approximately \$700,000 to be released within 60 calendar days of the date of final acceptance of the system. Metropolitan is also in the process of finalizing a four-year maintenance contract with JCI valued at \$1.143 million.

The Program Manager/Agreement Administrator, within the Security and Emergency Management Unit of the Water System Operations Group, and the Construction Contract

Administration Team, within the Program Management Unit of the Engineering Services Section (ESS), share responsibility in managing the contract administration process; and reviewing and approving JCI work plans and invoices. Additionally, an engineer within the Inspection Unit of the ESS is responsible for monitoring project activities; inspecting work performed by JCI; and determining project progress. Finally, the Accounts Payable Team, within the Controller Section in the Office of the Chief Financial Officer, is in charge of processing contract payments and maintaining related accounting records.

Opinion

In our opinion, the accounting and administrative procedures over the JCI contract include those practices usually necessary to provide for a satisfactory internal control structure. The degree of compliance with such procedures provided effective control during the period September 29, 2003 (inception of the agreement) through January 31, 2006.

Comments and Recommendations

During our review, we noted that the Accounts Payable Team recorded only the net payable amounts instead of recording the invoiced/approved amounts and related holdbacks in the Oracle Financial System. Upon further review of blanket order releases, we noted that while the Program Manager/Agreement Administrator approved the entire invoiced amounts via email correspondences, the Construction Contract Administration Team only released the net payable amounts in the Oracle Financial system. Consequently, the Accounts Payable Team recorded only the released amounts. This resulted in an understatement of liability for the remaining retained amount of approximately \$700,000 as of January 31, 2006.

Management concurred with this comment and has initiated remedial actions. Finally, we recommend that Controller Section management prepare a journal entry to record the remaining retained amount.