MWD
METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

Report
September 30, 2008
Office of the General Auditor

- **Internal Audit Report for September 2008**

Summary

Five reports were issued during the month:

- **Employee and Director Expense Reports Audit Report**
- **Accounting For and Billing of Reimbursable Projects Audit Report and Management's Response**
- **Rideshare Program Audit Report and Management's Response**
- **Internal Controls over Financial Reporting Audit Report**
- **Department Quality Assurance – Self Assessment Review**

Discussion Section
This report highlights the significant activities of the Internal Audit Department during September 2008. In addition to presenting background information and the opinion expressed in the audit report, a discussion of findings noted during the examination is also provided.

Employee and Director Expense Reports Audit Report

Background
Metropolitan's Administrative Code and Travel Guide specify travel policies, expense reporting procedures, and guidelines for preparing and submitting expense reports. Expense reports are processed through the Travel Expense Reporter (TER) system for directors and employees who have incurred travel expenses and operating expenses on behalf of Metropolitan. The Payroll and Accounts Payable Team from the Controller Section in the Office of the Chief Financial Officer administers, records expense reports, and issues payments.

For the twelve months ended March 31, 2008, expenses totaling approximately $2.7 million (4% decreases from prior year) were approved and processed through TER for employees, as well as directors. This total was made up of approximately $2.5 million in expenses claimed in 5,682 employee expense reports and $200,000 in expenses claimed in 178 director expense reports. Airfare, lodging, per diem of employees, conferences, and business mileage accounted for $1.95 million or 72% (9% increases from prior year) of total expenses incurred for the review period.

Opinion
In our opinion, the accounting and administrative procedures over employee and director expense reports include those practices usually necessary to provide for a generally satisfactory internal control structure. The degree of compliance with such procedures provided effective control for the period April 1, 2007 through March 31, 2008.

Comments and Recommendations

LATE SUBMISSION OF TRAVEL EXPENSE REPORTS AND OUTSTANDING PREPAID EXPENSES

Section 6331 (b) (2) and (3) of the Administrative Code requires that the directors' and employees' expense claims shall be submitted to the Office of the Executive Secretary and the Office of the Chief Financial Officer, respectively, no later than 60 days following the day director or employee incurred the expenses or participated in an activity for which District funds were utilized on the director's or employee's behalf. Our review of 5,820 employee and director expense reports submitted between April 1, 2007 and March 31, 2008, and analysis of outstanding prepaid expenses, revealed the following:

1. Employee expense reports were submitted late (beyond the 60 day standard) in 404 instances.

Expense Reports Submitted	No. of Expense Reports	Expenses Claimed
61 to 90 days	293	$105,666
91 to 365 days	111	$102,928
Total	404	$208,594
Total for Period	5,649	$2,531,686

2. Director expense reports were submitted late (beyond the 60 day standard) in 87 instances.

Expense Reports Submitted	No. of Expense Reports	Expenses Claimed
61 to 90 days	46	$35,421
91 to 365 days	41	$58,262
Total	87	$93,683
Total for Period	171	$210,939

3. Outstanding TERs for prepaid expenses: Travel Expense Reports for 481 items totaling $110,290 that were prepaid by Metropolitan's Travel Desk have not been submitted within the 60-day standard. These totals consist of 71 employees (with expenses totaling $87,622) and 19 directors ($22,668) as of March 31, 2008.

4. Pending reconciliation of prepaid expenses: Travel Expense Reports for 133 expense items (totaling $18,760) that were paid through company issued credit cards have been submitted however, these items have not been reconciled to the monthly credit card statements.

We recommend that Group Managers emphasize the importance of submitting travel expense reports within the 60-day guideline and conduct periodic tests to ensure compliance.

TRAVEL IN EXCESS OF 200 MILES ONE-WAY GUIDELINE

Section 6326 (d) of the Administrative Code requires that the type of transportation employed shall be selected on the basis of the lowest overall cost to the District after all costs are considered, including the travel time and the salary of the employee. This section also requires that trips which require travel in excess of 200 miles one-way shall be made by commercial airline. The reimbursements for any transportation costs for trips over 200 miles one-way by any form of transportation shall generally not exceed the standard round-trip airline coach airfare in effect at the time. These cost estimates are established by the Manager, Contracting Services, and include personal auto mileage and airport parking that would have been incurred and reimbursable, if airline transportation had been used.

We reviewed 24 selected travel expense claims (total 298 claims) with reported mileage over 200 miles one-way and noted that 23 of these claims were not provided with adequate information or explanation (i.e., cost consideration) for using personal car in lieu of air transportation. This is in contrast to Section 6326 (d) of the Administrative Code that requires consideration for transportation's lowest overall cost to Metropolitan.

DOUBLE PAYMENT OF CLAIMED EXPENSES AND MISSING SUPPORTING DOCUMENTATION

Review and approval controls serve to protect against unauthorized, inaccurate, or duplicate transactions or requests identify items that require correction, and ensure that follow-up procedures exist for exceptions. For expense reports, authorized personnel must review detail for compliance to policies and procedures, check attached documentation for completeness, and examine the claimed expenses for propriety.

We reviewed 438 potentially duplicated expense items ($25 and above) totaling $61,500 and noted double payments to thirteen expense items totaling $1,068. These expenses were claimed for reimbursement by five employees. We understand that the Payroll and the Accounts Payable Team has contacted the five employees to seek reimbursement. We were informed that three employees had already paid $574 to Metropolitan and that the other two employees have agreed to pay the remaining amount ($494) to Metropolitan. Furthermore, to avoid future double payments, the Payroll and Accounts Payable Team and the IT Section of the Corporate Resources Group have developed a "Duplicate Transaction Report" module in the Travel Expense Reporting system. This reporting module, which is currently being tested, will be implemented in 2009 and will be used to detect potential duplicate expenses.

Accounting For and Billing of Reimbursable Projects Audit Report

Background

Reimbursable Projects (ORACLE 70xxx Series) are contractual relationships under which Metropolitan provides a product or service to another party and a portion or all of the costs incurred are paid by the contracting entity. These projects can originate from any group and vary from construction related activities, to water quality research grants, to water planning and conservation programs, to other water related initiatives. Water Systems Operations (WSO) and Corporate Resources Group (CRG) administer the construction and water quality research projects; Water Resources Management (WRM) administers the water planning and conservation projects; and other Groups (e.g., External Affairs or Real Estate) administer different water related initiatives or tenant improvements. The contracting or originating entities also vary from member agencies, non-member public or private agencies, federal or state grant programs, and other non-profit organizations.

As noted, Project Managers from each Group are assigned responsibility for the administration of the reimbursable projects. These managers monitor project activities, review expenditures, approve cost reimbursement requests, request periodic project billing and cost transfers, and prepare Management reports. As support for these activities, the Project Coordination Office of CRG is responsible for establishing and closing projects upon request from the Project Managers. In addition, the Controller Section is responsible for activating account numbers for new projects, processing periodic billings and processing costs transfers based upon requests from project managers.

Operating Policy (OP) C-01"Accounting for and Billing of Reimbursable Projects" and the Administrative Code establish the general policies and procedures for the administration of reimbursable projects. In addition, OP C-09 "Remittance Handling Processing" establishes policies for collecting and reporting remittances such as advances and reimbursements for these contracts. Finally, Operating Policy C-21 "Accounting and Administration of Federally Funded Grants (and Cooperative Agreements)" and the Accounting and Administrative Procedures for Federally Funded Grants" establish policies and procedures relating to federal grant projects.

Reimbursable Project Types

Reimbursable projects can be separated into two broad categories: those that require an advance deposit prior to the initiation of work and those that require eligible costs to be accumulated and billed periodically pursuant to contract terms to the contracting entity or grantor.

Service Connections and Substructures are reimbursable projects that require an advance deposit (usually partial funding) from the responsibility entity prior to the initiation of work. Service Connection projects connect Metropolitan's distribution system with that of a Member Agency, and they are administrated by a joint effort between the WSO Group Manager's Office and the CRG Engineering Services Section. Substructure projects, on the other hand, consist of Engineering Service Section review of private developers, contractors and/or other agencies development projects for their impact on Metropolitan's facilities and rights-of-way, or to assess the need to modify our facilities to accommodate these projects.

Funds deposited with Metropolitan for these projects are held in escrow and used to defray the costs of completing the project. Upon completion, reimbursement is requested from the responsibility entity for all costs incurred that exceed the advanced funding or a refund of excess funds being held is made to the entity.

All other reimbursable projects require eligible costs to be accumulated and billed periodically to the contracting entity or grantor. Examples of these projects include those initiated by WSO with federal, state, or other public agencies such as Federal Emergency Management Agency (FEMA) - California Department of Emergency Services or Los Angeles Department of Water and Power (DWR). WSO also administers Water Quality Research Projects such as the DWR Safe Drinking Water Project, the United States Environmental Protection Agency Remediation Project, and the AWWARF Wastewater Project.

Likewise, CRG administers various reimbursable projects such as the Dental Health Foundation Project, construction efforts with Calleguas Metropolitan Water District and on the Coachella Canal, and the FEMA Santa Ana Bridge Crossing Project. Further, WRM administers reimbursable conservation projects such as DWR Proposition 13 and 50 Projects, CUWA-Management of Category III Programs, and the United States Bureau of Reclamation California Friendly Project. Finally, other reimbursable projects are initiated and administered by other Groups such as External Affairs (World Water Forum – Los Angeles Sanitation District) and the Real Estate Team (Union Station, Tenant Improvements for State of California).

In some instances, Metropolitan sub-awards these grants to Member Agencies and other outside entities to perform a portion of work. As noted above, eligible costs incurred for these projects are billed periodically pursuant to contract terms to the grantors or are billed upon project completion.

Altogether, as of September 2007, there were 213 open reimbursable projects. This total consisted of 105 projects with outstanding and unbilled charges totaling $22.2 million and 108 projects with outstanding deposits totaling $10.3 million. In addition, there were 76 closed reimbursable projects with ineligible costs or excess deposits totaling $6.1 million that remained on the ORACLE database.

Opinion

In our opinion, the Accounting for and Billing of Reimbursable Projects provide for a less than satisfactory internal control structure. This opinion is the result of non-billing or late billing of eligible costs from three months to thirty-six months; advanced deposits and cost reimbursement requests not processed through the Accounts Receivable invoicing system; and remittances received by improper agents. Further, we noted overstated reimbursable project costs and missing or incomplete project documentation. It should be noted that Management has initiated remedial actions in response to our concern, and we will assist in the evaluation of solutions addressing these internal control structure concerns.

Comments and Recommendations

COMPLIANCE WITH TERMS AND CONDITIONS OF THE AGREEMENTS

Operational policies and procedures are established to provide a framework for achieving company goals and objectives. Procedures provide guidelines for consistent performance of daily operations, assist in the training of new employees, and provide a source of reference for experienced personnel. Compliance with these policies and of the terms and conditions of the reimbursable contract is necessary to ensure accurate accounting records, proper supporting detail, and adequate control over the administration of the agreement. Compliance with the contractual terms and conditions of the agreements also ensures that the parties fully discharge their obligations and exercise their rights.

Our test work revealed numerous instances of non-compliance to established procedures and/or to the terms and conditions of the reimbursable contract. Furthermore, we also noted instances where policies and procedures were deficient in providing the necessary guidance and direction to ensure adequate control over reimbursable projects.

Non-compliance with established procedures could result in a loss to the District if expenditures made on a reimbursable contract were not billed to the contracting entity. Financial loss could also occur if deposits received in advance were returned to the responsible party in error as a result of an incomplete or inaccurate accounting. Non-compliance has resulted in late billings and in the failure to properly close completed reimbursable projects.

The following comments and recommendations describe departures from established operating procedures and offer suggestions for improvement in the internal control structure. These comments are organized by type of reimbursable project.

Service Connections-Engineering Services Section and Water System Operations
(11 Projects with Outstanding Charges-$1.4 Million and 13 Projects with Outstanding Deposits-$1.6 Million)

Our review of ten projects (5 projects with outstanding charges-$1.2 million, and 5 projects with outstanding deposits-$1.3 million) revealed:

1. Reimbursable costs of $682,000 that were incurred in FY 2006-07 for two projects (No. 701722 “CLWA-01T”-$442,000 and No. 701669 “EM-22”-$240,000) were not billed until June 2007. It should be noted, however, that an advance deposit of $1.1 million covering these costs plus estimated costs-to-complete were received in November 2007.

2. Reimbursable costs of $508,000 that were incurred between FY 2004-05 and the first quarter of FY 2007-08 (39 months) for three projects (No. 701486 “CENB-54”-$248,000, No. 701595 “CENB-55”-$133,000 and No. 701664 “EM-01A”-$127,000) were unfunded as of January 2008. Project Management indicated that although construction activities were completed in prior years, the as-built drawings for these projects have yet to be finished. We understand that the Member Agency will be invoiced for these balances at that point.

3. Project No. 701634 “B-06” had an unfunded balance of $40,128 as of January 2008. Further investigation revealed that this project had an outstanding deposit balance as of September 2007 and additional costs were recorded against this project in error. We understand that Project Management will transfer these costs to the appropriate projects.

4. Advance deposit requests and final payments for Service Connections Projects were not processed through the Accounts Receivable invoicing system. Accordingly, these requests were not accompanied with invoices when submitted to the contracting entity for payment. As a result, the advance deposit transactions were recorded to the general ledger only when

remittances were received and deposited to bank account by the Treasury Section. Furthermore, we noted that the WSO Group Manager's Office receives all Service Connections remittances and "hand-carries" these items to the Treasury Section for deposit. However, Operating Policy C-09 "Remittances Handling / Processing" does not specify the WSO Assistant Group Manager's Office as an authorized agent to receive remittances for Metropolitan. Further, this process presents undue secure custody risk to WSO.

5. There is a lack of formal documentation that describes the responsibilities for reviewing and approving project authorization requests. As a result, we noted that two project authorization requests tested ((project #s701486 and 701595) were not approved by the General Manager, although Form 540 requires his approval. We did note, however, that Form 540 was revised in FY 2002-03 such that approval is granted by the Group Manager.

6. The Service Connection Agreement for projects No. 701722, No. 701714 and No. 701721 is still in progress for signature.

We recommend that WSO Group Manager's Office and CRG Engineering Services Section Management work with the Controller's Section to resolve the noted discrepancies. We also recommend that the WSO Group Manager's Office coordinate all deposit/funding requests to the Revenue and Receivables Unit for invoicing and recording purposes. Furthermore, we recommend that the WSO Group Manager's Office inform contracting agencies to remit payments directly to the Treasurer Section.

In addition, we recommend that the CRG Project Coordination Office work with the Controller to ensure that formal documentation is prepared and adopted that appropriately describes the review and approval process for establishing reimbursable projects. We also recommend that the WSO Group Manager's Office or Engineering Services Section maintain/update master program files for all Service Connections projects complete with project documentation (e.g., approved project authorization request, service connection agreement). Finally, we recommend that WSO and CRG Management conduct periodic reviews to ensure compliance to operating policies, the Administrative Code and to the terms and conditions of the contracts.

Substructures Reimbursable Projects-Engineering Services Section
(22 Projects with Outstanding Charges-$298,000 and 73 Projects with Outstanding Deposits-$316,000)

Our review of 10 projects (5 projects with outstanding charges-$206,000 and 5 projects with outstanding deposits-$112,000) revealed:

1. Although all were listed as active projects on the September 2007 report, the project descriptions state that they were to be completed between 1998 and 2004. Furthermore, our review revealed that there had been no activity on nine of these projects for several years. Specifically, we noted that nine of the projects have been inactive since FY 2005-06 (some since FY 04/05), and their outstanding charges (4 projects totaling $188,000) or advanced deposits (5 projects totaling $112,000) remained unbilled or had not been refunded as of January 2008. A list of these projects has been provided to Management. It should be noted

that the Substructures Team stated that work on these projects is often in response to external requests or non-Metropolitan construction activities and noted that it is not unusual for a project to remain dormant for a significant period of time (several months to years). Prior to issuance of this report, the Substructures Team identified 10 of 95 projects for closeout, including 6 of the projects selected for our review.

2. Deposits of $20,600 on Project #700967 were authorized for refunding in December 1994 but were not processed. Further review revealed that prior to the refunding additional costs of $5,100 were incurred. In addition, we understand that Management concluded in March 1995 that the project was prematurely identified for closure and that substantial work remained to be completed. We also note that the Substructures Team will reassess this project for possible closeout in the next few months.

3. Reimbursable costs of $15,000 for Project #701655 were billed in June 2007 and remain uncollected as of January 2008. Furthermore, additional costs of $2,200 were incurred after the June 2007 billing. Substructures Team Management indicated that the contracting entity did not respond to the June 2007 request for additional deposits. Management also indicated that it submitted a project completion request to Project Coordinating Office in March 2008, with directions to present a final bill to the contractor.

4. Contract agreements for three of ten projects (#'s 700967, 701421 and 701426) could not be located. Substructures Team Management indicated that written agreements were not required when Project #700967 was opened. Furthermore, Management noted that for project #701421 the project was subsequently been determined to be an O&M responsibility and thus should be closed. Finally, for project #701426, the Substructures Team has attempted unsuccessfully to obtain a copy of the agreement.

5. There is a lack of formal documentation that describes the responsibilities for reviewing and approving project authorization requests. As a result, we noted that project authorization requests for eight of ten projects (a list was provided to Management) were not approved by the General Manager, although Form 540 requires his approval. We did note, however, that Form 540 was revised in FY 2002-03 such that approval is granted by the Group Manager.

6. Advance deposit and final payment requests for Substructures Projects were not processed through the Accounts Receivable (AR) invoicing system. Accordingly, these requests were not accompanied with invoices when submitted to the contracting entity for payment. As a result, the advance deposit or final payment transactions were recorded to the general ledger only when remittances were received and deposited to the bank by the Treasury Section. Furthermore, we noted that the Substructures Team receives the majority of Substructures remittances and "hand-carries" these items to Treasurer's Office for deposit. However, we noted that Operating Policy C-09 "Remittances Handling/Processing" does not specify the Substructures Team as an authorized agent to receive remittances for Metropolitan. Further, this process presents undue secure custody risk to CRG Engineering Services Section.

We recommend that the Engineering Services Section Substructures Team Management work with the Controller's Office to resolve the noted discrepancies. We also recommend that the

Substructures Team coordinate all deposit/funding requests to the Revenue and Receivables Unit for invoicing and recording purposes. Furthermore, we recommend that the Substructures Team inform contracting entities to remit payments directly to the Treasurer's Office.

In addition, we recommend that the CRG Project Coordination Office work with the Controller to ensure that formal documentation is prepared and adopted that appropriately describes the review and approval process for establishing reimbursable projects. We also recommend that the Substructures Team maintain/update master program files for all substructure projects complete with project documentation (e.g., approved project authorization request, substructures agreement). Finally, we recommend that CRG Management conduct periodic reviews to ensure compliance to operating policies, the Administrative Code and to the terms and conditions of the contracts.

Federal Emergency Management Agency (FEMA) Projects-Water System Operations
(57 Closed Projects-$4.7 million "Exhibit F" and 9 Open Projects-$84,000)

Our review consisted of an overall assessment of the administration of FEMA reimbursable projects and a detailed review of 17 projects ($3.6 million). We noted:

1. The 57 closed projects were funded under the FEMA's 1993 Storm and 1994 Northridge Earthquake disaster programs and were closed between 1994 and 2000. However, non-reimbursable (i.e. ineligible) costs of $4.9 million for 42 projects and excess advanced deposits totaling $212,000 for 15 projects remained in the ORACLE database as of September 2007. Further investigation revealed that the Controller's Office researched these matters and processed adjustments in June 2007 to transfer these balances to the appropriate O&M and capital accounts. These adjustments, however, did not "clear" these balances at the time. Management has since corrected this matter.

2. Although the aforementioned 57 projects were completed between June 1993 and September 1998, they were closed from seven to eighteen months after the project was completed. This is in contrast to the Accounting and Administrative Procedures for Federally Funded Grants that requires the Federal Grant Administrator (FGA) to periodically review the status of projects to ensure timely closeout.

3. Our detailed review of the 17 FEMA projects (all closed status) revealed that funding requests were submitted on an irregular basis and not processed through the Accounts Receivable invoicing system. Accordingly, these requests were not accompanied with invoices when submitted to FEMA for reimbursement. This is in contrast to the Accounting and Administrative Procedures for Federally Funded Grants that requires the FGA to submit invoice requests to the Accounts Receivable section for timely billing. As a result, FEMA transactions were recorded to the general ledger only when remittances were received and deposited to the bank by the Treasurer's Office.

4. Master grant files for closed FEMA projects were incomplete which is in contrast to the Accounting and Administrative Procedures for Federally Funded Grants that requires the FGA to maintain a master file for each grant project complete with all required project and grant

documentation. Master grant files contain information such as notice of award, grant application/ proposal, project authorization, closeout documents, federal reports and financial status reports. It should be noted, however, that the master grant files for current and most recent FEMA funded projects are fully maintained and kept by FGA.

5. Our detailed review of five FEMA open projects (2 projects with costs totaling $200,100 and 3 projects with advanced deposits of $233,100) revealed the following discrepancies. Three projects (#'s 701281, 701283 and 701246) that were funded under the 1993 Storm and 1994 Northridge Earthquake disaster programs and completed between June 1993 and September 1998 remained open as of September 2007. We did note that prior to issuance of this report these projects were closed and the accounting department made appropriate closing entries. In addition, we noted that two projects (#'s 701677 and 701678) that were funded under the 2005 Storm Disaster Program and completed in June 2006 also remained open as of September 2007. Further review revealed that these projects cannot be closed until final funding from the Disaster Agency is received sometime in late 2008.

We recommend that WSO Management develop policies and procedures reflective of current FEMA reimbursement process and closeout procedures and incorporate them to appropriate operating policies and the "Accounting and Administrative Procedures for Federally Funded Grants." We also recommend that WSO Management work with the Controller's Office to resolve the noted discrepancies. Furthermore, we recommend that the WSO coordinate all FEMA funding requests to the Revenue and Receivables Unit for invoicing and recording purposes. Finally, we recommend that WSO Management conduct periodic reviews to ensure compliance to operating policies, the Administrative Code and to the terms and conditions of the contracts.

Water System Operations-Water Quality Reimbursable Projects
(12 Open Projects-$3.9 Million and 1 Closed Project-$1.4 million)

Our review of six reimbursable projects (5 open projects totaling $3.6 million and 1 closed project totaling $1.4 million) revealed:

1. Reimbursable costs totaling $1.2 million that were incurred in FY 2005-06 and\or FY 2006-07 for two projects (#'s 701673 and 701676) were not billed until December 2007 (6 to 24 months). We also noted that the reimbursable costs for project #701676 were billed only at 90%. The 10% difference represents the required retention deposits not billed (totaled $133,000) as of January 2008.

2. Reimbursable costs totaling $668,000 that were incurred between FY 2004-05 and the first quarter of FY 2007-08 for three projects (#'s 701632, 701662 and 701711) were unbilled as of January 2008 (7 to 39 months). It should be noted that project # 701632 was billed in May 2008.

3. Non-reimbursable in-kind service costs of $3 million that were incurred since FY 2005-06 remained recorded to four projects as of September 2007. This is in contrast to the Controller's Office mandate issued in early 2006 that these costs be transferred to the appropriate capital or O&M projects. The details were provided to Management.

We recommend that WSO Water Quality Section Management work with the Controller's Office to resolve the noted discrepancies. We also recommend that WSO Management conduct periodic reviews to ensure compliance to operating policies, the Administrative Code and to the terms and conditions of the contracts.

Water Resources Management Reimbursable Projects
(20 Projects with Outstanding Charges of $12.5 Million and 1 Project with Advanced Deposits of $7.5 Million)

Our review of five reimbursable projects with outstanding charges of $10.2 million revealed:

1. Reimbursable costs recorded to one project (#701689) were overstated by $2.8 million. Specifically, we noted that these costs consisted of financial incentives paid in advance by Metropolitan for Member Agencies' share of rebate payments under the Commercial, Industrial and Institutional Rebate Program. These advances are to be recovered by Metropolitan through adjustments to the monthly water billing to Member Agencies. However, we noted that these recoveries were recorded in error as a deduction to conservation credits (expenses) rather than as offsets to recorded project costs. As a result, cumulative expenses were also understated by $2.8 million as of January 2008. It should be noted that prior to the issuance of this report, the Controller's Office made correcting entries for the overstated project costs.

2. Reimbursable costs of $2.4 million that were incurred between FY 2006-07 and the first quarter of FY 2007-08 for three projects (#'s 701611, 701551 and 701590) were billed in January, February or March 2008.

3. There is lack of formal documentation that describes the responsibilities for reviewing and approving project authorization requests. As a result, we noted that Project Authorization Requests for three projects (#'s 701590, 701611 and 701592) were not approved by the General Manager, although Form 540 requires his approval. We did note, however, that Form 540 was revised in FY 2002-03 such that approval is granted by the Group Manager. In addition, we noted that the Project Authorization Request (Form 540) for one project (701551) could not be located.

We recommend that WRM Management work with the Controller's Section to resolve the noted discrepancies. We also recommend that WRM Management conduct periodic reviews to ensure compliance to operating policies, the Administrative Code and to the terms and conditions of the contracts.

Rideshare Program Audit Report

Background
In January 1989, Metropolitan established the Rideshare Program – Trip Reduction plan to reduce the number of employee-driven vehicles arriving at Los Angeles Headquarters and La Verne facilities, as a result of the South Coast Air Quality Management District (SCAQMD)

Regulation XV (replaced by Rule 2202). Since inception, the Rideshare Program has included a transit subsidy, carpooling, vanpooling, and a guaranteed ride home component. The Rideshare Program began with four leased vanpool vehicles and a transit subsidy of $15. Today, the vanpool program consists of 53 vehicles (19 leased and 34 Metropolitan owned) covering 11 Metropolitan destinations. Leased vehicles cost between $680 and $795 per month. The transit subsidy component of the Rideshare Program is capped at $125 per employee per month and Metropolitan does not subsidize carpooling. Vanpool and transit benefits are employee benefits covered by collective bargaining agreements and are subject to Internal Revenue Service regulations.

Effective January 1, 2008, the Management of the Rideshare Program was transferred from Human Resources, Benefits and Employee Services Unit to Corporate Resources, Business Services Section, and Office of Business Services Team. The Fleet Services Unit, within the Water System Operations Group is responsible for maintaining vanpool vehicles (leased or owned), tracking and reporting fuel and mileage usage in the Maximo system. The Risk Management Unit within the Human Resources Group handles property damage claims.

Opinion

In our opinion, the accounting and administrative procedures over the Rideshare Program provide for a less than satisfactory internal control structure. This opinion is the result of deficient business practices, lack of policies and procedures, ineffective program controls and lack of enforcement of program guidelines. It should be noted that Metropolitan Management requested that this audit be completed as responsibility transferred from the Human Resources Group to the Corporate Resources Group. It is also important to note that Management had identified control concerns and initiated remedial actions prior to the start of our audit. We will continue to assist in the evaluation of solutions to the internal control structure concerns.

Comments and Recommendations

POLICIES AND PROCEDURES

Policies and procedures should be established and documented to provide a framework for achieving compliance with the Rideshare Program objectives and to maintain compliance with the collective bargaining agreements. Procedures assist Management in the training of new employees, provide guidelines for consistent performance of daily operations, and provide a source reference for experienced personnel. Procedures can be operational based and designed to regulate day-to-day activities relative to scheduling, specifications, and costs or they can be organizational and targeted to perform a review and evaluation of program achievements.
Our review revealed that operational and organizational policies and procedures have not been developed for:

1. Cost tracking and analysis of transit, vanpool and total program costs.

2. Minimum ridership requirements to qualify employees for the vanpool program. This has resulted in vanpools including employees with extended leave (ALT, BER, SIC, HOL) or district assignments (shutdown, field response) in their count towards the minimum ridership requirement even though they do not ride in the vanpool in these instances. It is important to

note that the vanpool agreement does not specify that these cases qualify as "special circumstances" for participation in the program.

3. Billings to Enterprise Rent-A-Car Company for maintenance services performed on leased vehicles. It is important to note that billings to Enterprise for these services are assigned to the Administrative Assistant of the Fleet Services Unit. This is contrary to the District's practice within the Controller's Office.

4. Obtaining a legal opinion for income tax reporting of the transportation (vanpool) fringe benefits prior to the implementation of the program. It is important to note that Management has recently received a legal opinion that supports the reporting policies and procedures of the program.

We recommend that Metropolitan management develop policies and procedures for the Rideshare Program and coordinate with the Controller's Office for billings to Enterprise Rent-A-Car Company.

RIDESHARE PROGRAM CONTROLS AND GUIDELINES

Good governance requires a single system of record to ensure consistent, effective, and efficient coverage of legal contracts, laws, and internal company policies. Management reports derived from these records should be designed to combine information into a meaningful form so management can assess operations and develop effective strategic plans. These reports can be informative (e.g., measurement of volume) or analytical (e.g., exception listings). For the Vanpool Rideshare Program, actual costs and participation records should be tracked and periodically reported to management for review and analysis. These monitoring controls and analytical tools aid in ensuring that program performance aligns with management expectations and they allow for the timely implementation of corrective measures.

During our review, we noted that the Benefits Employee Services account (Oracle Project #901254) was designed to track all employee benefits, including the Rideshare Program activity. However, detailed testing revealed that transit fringe benefits costs of $568,000 (G/L #4330020) and Enterprise leased vanpool vehicles costs of $116,000 (G/L #4440080) are the only costs components reported under this project. That is, other costs associated with the Rideshare Program (fuel, maintenance, property damage/injury claims), which are tracked in Maximo and Oracle were not captured. It is important to note that Rideshare Management has begun efforts to accumulate these costs.

In addition, our review revealed that Voyager fuel purchases were made during the Diemer Plant construction, as a result of the fuel pumps being out of service. However, we were unable to analyze vanpool fuel costs because they are not identified separately from other fleet vehicles.

We recommend that the Rideshare Program Manager work in concert with Fleet Services, Human Resources, Controller, Purchasing, and Information Technology to ensure that all program costs are accounted for and captured. In addition, we recommend that Management develop procedures to monitor and analyze these costs to assure appropriate use of and accountability for District resources and to evaluate program performance against its objectives.

RECONCILIATION OF VEHICLE, MAINTENANCE, FUEL AND MILEAGE DATA

Accounting control is achieved, in part, by performing periodic reviews and reconciliations of the accounting records. These procedures are designed to ensure the accuracy and reliability of financial and operational data and they ensure the appropriate use of and accountability for District resources. For the Vanpool Rideshare Program, van pool maintenance costs (parts and labor) for leased vehicles should be reconciled between totals shown in Maximo against amounts billed to Enterprise Rent-A-Car Company for reimbursement. In addition, mileage and fuel usage for vanpool commuting should be reconciled between the Maximo fuel logs and the Fleet Services mileage records. Our test work revealed:

1) ***Maximo records versus Enterprise Rent-A-Car Company billings***
   - Discrepancies between Maximo records and invoices to Enterprise. Specifically, we were unable to trace and agree amounts shown in Maximo for parts and labor to line items on the invoices presented to Enterprise for reimbursement. Furthermore, we noted that the timing of these invoices was inconsistent.

   - Chargeback amounts for maintenance services (parts and labor) lacked consistency.

   - Differences between the amounts billed to Enterprise and receipts posted to the Rideshare account (G/L #4440080). Specifically, we reviewed eight invoices from the period April 1, 2005 through March 31, 2008 totaling $4,275 and traced these to the general ledger. However, our review of the Rideshare account revealed only five items totaling $2,309. We understand that this difference may result from a duplicate invoice being issued by mistake, an incorrect posting of the funds to the wrong G/L account, or from the non-payment of the receivable. Our test work was inconclusive as to the cause of this difference.

   - Finally, payments received from Enterprise were not always applied to the proper project. Further review revealed that this was the result of the fact that the Controllers' staff was not always informed of the particulars of payments received.

2) ***Maximo versus Monthly Mileage Card for March 2007, August 2007, and April 2008***
   - Discrepancies between the Monthly Mileage Card and the Fleet Services Unit log (Maximo). Our review revealed that vanpool drivers are required to submit a monthly mileage card showing the odometer reading at the beginning and end of each work day. Moreover, each time a vanpool driver refuels at a District facility they record the vehicles mileage on the fleet services log. Our test work noted differences between these records. These differences may be a result of an input error when keying mileage data into Maximo, incorrect recording of commuted mileage on the mileage card, or a timing difference between Rideshare reporting and the Maximo vanpool fuel date. Specifically, we selected six vanpools and reviewed activity for March 2007, August 2007, and April 2008 with the following results.

- ***March 2007 activity*** - Four vanpools reported lower total miles commuted (by 5 to 46%) on the Monthly Mileage Card than was listed on the Fleet Services Unit log and one reported a higher total of commuter miles (by 6%).

- ***August 2007 activity*** - Three vanpools reported a higher total of miles commuted (by 5% to 23%) on the Monthly Mileage Card that was listed on the Fleet Service Log and three reported a lower total (by 6 to 34%).

- ***April 2008 activity*** - Three vanpools reported a higher total of miles commuted (by 5% to 41%) on the Monthly Mileage Card that was listed on the Fleet Services Log and two reported a lower total (by 10 to 78%). In addition, we were unable to obtain Maximo fuel and mileage data for one van (#3721).

Note: These vehicles commuted between 22 and 150 miles per day (or 320 to 3,076 miles/month) and were stationed at Union Station or the Weymouth Filtration Plant.

- Incomplete or inaccurate data entry. Specifically, we noted several instances where data fields were not completed and/or were inaccurate (e.g., beginning and ending odometer readings, employee identification number). Further review revealed that similar fields exist on both the Monthly Mileage Card and on the Vanpool Roster that require the user to record the same information into both documents. This redundancy creates opportunities for inaccuracies or inconsistencies. We also noted instances where the monthly mileage card did not agree with the monthly vanpool roster (commuting date, mileage) for two vans selected for April 2008, one for August 2007 and two for March 2007.

3. ***Expected Monthly Fuel Usage versus Actual Fuel Used***

- Differences between the expected monthly fuel needs and the actual fuel used were noted. Our review consisted of calculating the fuel needs of van pool vehicles by using the average miles-per-gallon for the respective model/year (source: Fueleconomy.gov) and estimating the fuel needed based on the miles commuted during the month. We selected six vans and computed the fuel needs for March 2007, August 2007, and April 2008. We compared the expected monthly fuel usage against the actual gallons pumped at Metropolitan's fuel stations and recorded in Maximo. We noted:

  - ***March 2007*** - Two vehicles used less fuel than expected (by 38% to 40%).

  - ***August 2007*** - One vehicle used more fuel than expected (by 38%) and one vehicle used less fuel than expected (by 180%).

  - ***April 2008*** - Three vehicles used less fuel than expected (by 29 to 68%). We were unable to obtain fuel and mileage data from Maximo for one van (#3721).

Note: The large differences cited might be the result of incomplete and/or inaccurate recording of fuel usage in the Maximo database or could be a result of using a Voyager card to purchase fuel. If a Voyager card was used to purchase fuel then the Maximo records would not have been updated and the fuel records would be understated. We have provided these differences to Management.

4. ***Vehicles assigned to Rideshare Program***

- Discrepancies between the Maximo and Oracle records of Metropolitan owned vehicles assigned to the Rideshare Program with that of Rideshare database. We noted:

  - Four vehicles (#3700, 3641, 3725, & 2976) shown in Maximo as assigned to Rideshare were excluded from the Rideshare database. Per discussion with Rideshare Program Management, these vehicles already had been released back to the Fleet Services Unit. In addition, we also noted that two of these vehicles (#3700 & 3641) were assigned to Rideshare per the Oracle database. Upon further review of Maximo, we noted that vehicle #3725 is located at the Laverne Garage and #2976 at the Lake Mathews Garage.

  - Five vehicles (#4165, 3691, 3701, 4163, 3709) used for vanpool purposes were included in the Rideshare database and Maximo, but not in Oracle.

We recommend that Rideshare Program, Fleet Services Unit, and Inventory Management resolve the noted discrepancies. We also recommend Management establish procedures to ensure that all vanpool activities are properly recorded, tracked and reconciled.

COLLECTIVE BARGAINING AGREEMENTS

Pursuant to the Administrative Code, the Memoranda of Understandings (MOUs) between Metropolitan and the Employees Association/AFSCME Local 1902 (AFSCME), Management and Professional Employees Association/AFSCME Local 1001 (MAPA), Association of Confidential Employees (ACE) and Supervisors' Association sets forth the full and entire understanding of the parties regarding matters within the scope of representation. Accordingly, the Rideshare and Parking section of the MOUs should identify rights and responsibilities of each party. Our review revealed:

1. Original documentation or side letter agreement that memorializes the intent or summarizes the benefits and responsibilities of Metropolitan and the bargaining units for the Rideshare Program could not be located. Accordingly, there is confusion and disagreement as to the intent and interpretation of Rideshare Program components. For example, there is disagreement regarding the waiting period for a vanpool vehicle after minimum ridership requirements have been met. Furthermore, and adding to the confusion, we note that three of the four MOUs (ACE has “favored nation” status) state that "there will be no changes to the current Rideshare Program including vanpools, carpools, rapid transit, and parking without meeting and conferring." This reference implies the existence of a formal agreement between Management and the bargaining units which we could not locate.

2. Conflict between the Rideshare Guaranteed Ride Home Program and the Districts emergency needs. Specifically, the MOUs state that “employees who participate in the Rideshare

Program will be given a ride home in the event that an unplanned emergency or District directed work prevents them from using normal rideshare transportation methods." However, our review of the Chino Hills earthquake (July 29, 2008) "After Action Report" revealed the need to ensure that vehicles are available for business purposes (damage assessment and emergency response) prior to consideration of the Guaranteed Ride Home Program.

3. Potential conflict between the van pool and the bargaining agreements. That is, the van pool agreement states that Metropolitan can "change, modify or amend the Vanpool Program at any time with five working days written notice" and, furthermore, can "terminate the vanpool program at any time with a 30-calendar-day written notice". Whereas, the bargaining agreements stipulates meet and confer conditions.

We recommend that Metropolitan Management review its current practices to ensure vehicles are available for business use, as well as meeting MOU requirements. We also recommend that Management and the bargaining units work together to ensure that matters set forth in the MOU are clear, complete, and formally documented.

COMPLIANCE WITH VANPOOL AGREEMENT AND PROGRAM GUIDELINES

Compliance with vanpool agreement and program guidelines is necessary to ensure accurate tracking and reporting of program activities and adequate control over the administration of the Vanpool Rideshare Program. Compliance with the above also ensures that Metropolitan complies with the South Coast Air Quality Management District (SCAQMD) Rule 2202 requirements.

We selected six vanpools (three from Union Station and three from Weymouth) and reviewed participation activities for March 2007, August 2007, and April 2008. It is important to note that Rideshare Management has initiated corrective measures. Our review revealed:

1. Completed Rideshare Vanpool Agreements were not on file for 10 of 47 participants.

2. Minimum requirement for one (US0025) of six vans tested during the month of April 2008 was not met.

3. Participation records did not agree with Worktech attendance records for 9 of 34 instances for March 2007; 10 of 37 for August 2007; and 8 of 38 participants for April 2008. For example, the vanpool records reported an employee as a rider while Worktech records revealed that the individual was on leave (SIC, ALT, PLT). It should be noted that Rideshare Management currently does not have access to Worktech attendance records.

4. Minimum ridership requirement of three days per week or twelve days per month for 15 of 34 in March 2007; 10 of 37 in August 2007; and 15 of 38 in April 2008 was not met. It is important to note that Audit did not count leave days (ALT, SIC, PLT) or district assignments (shutdowns, field responses) towards this minimum requirement. Although the vanpool agreement does not specify that these instances qualified as "special circumstances," they are accepted as a standard practice.

5. Drivers did not comply with District standards in 2 of 38 instances. We also noted instances where identification badges of vanpool passengers were used to gain access through gate entrances. Metropolitan's standards requires that drivers possess a valid California driver license, complete Metropolitan's Defensive Driving course, and pass a Department of Motor Vehicle (DMV) medical exam.

6. One driver (April 2008 participant) did not hold a current Department of Motor Vehicle medical certificate and two drivers (April 2008 and March 2007 participants) did not complete the Defensive Driving course.

7. Rideshare staff does not verify validity and accuracy of DMV driver's license information indicated on the vanpool agreements and signed by vanpool drivers.

Non-compliance with Metropolitan standards could result in financial exposure to the District if a non-qualified driver is operating a vehicle that is involved in an accident. Failure to comply with the minimum ridership standards could result in the improper use of District resources and may prevent the program from achieving planned objectives.

We recommend that Rideshare Program Management remind vanpool participants of the importance of adhering to program requirements and conduct periodic reviews to ensure compliance.

Internal Controls over Financial Reporting Audit Report

Background

In October 2007 Metropolitan's Board of Directors amended the Administrative Code to require the General Auditor to express an opinion as to the effectiveness of internal controls over financial reporting (Administrative Code Section 6451(c)). Accordingly, we have reviewed the internal control over financial reporting of Metropolitan as of June 30, 2008.

We conducted our audit in accordance with professional standards that require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the General Manager and Chief Financial Officer, and effected by the company's Board of Directors, Management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of Management and Directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Opinion
In our opinion, Metropolitan maintained, in all material respects, effective internal control over financial reporting as of June 30, 2008, based on the criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Audit Department Quality Assurance – Self Assessment Review

Background
Ensuring that Metropolitan's Audit Department exhibits a high degree of professionalism, independence, and integrity, we adhere to the Standards for the Professional Practice of Internal Auditing (Standards), promulgated by the Institute of Internal Auditors (IIA). Meeting these requirements, internal audit departments must develop and maintain quality assurance and improvement programs. Such programs should be designed to help ensure that the internal audit activity is in conformance with the Standards and the Code of Ethics, and should assist the internal auditing activity in adding value and improving the organization's operations. According to the Standards, a comprehensive Quality Assurance Program includes the following elements:

1. Periodic internal assessments of the work of the Internal Audit Department.

2. External assessments or quality assurance reviews of the work of the internal auditing department, at least once every five years.

3. Ongoing internal monitoring.

An integral requirement of the Standards involves periodic internal assessments of the Audit Department. Accordingly, we conduct periodic quality assurance self-assessments of the Audit Department in order to examine our continued compliance to the Standards, to evaluate our effectiveness in carrying out our mission, to identify opportunities to enhance management and work processes, and to enhance the Audit Department's value to Metropolitan. The self-assessment includes a review of the risk assessment and audit planning processes; evaluation of audit policies, procedures, and practices; assessment of Audit Management methods; completion of anonymous client and audit staff satisfaction surveys; and a thorough examination of selected audit work papers. We completed the documentation of this self-assessment in September 2008.

Additionally, every five years external quality assurance reviews must be performed by qualified, independent reviewers external to the organization. This review will again be performed during Fiscal Year 2011-12.

<u>Scope and Procedures</u>
In September 2008, the Audit Department completed a quality assurance self-assessment. The IIA Quality Assessment Manual and Assessment Report were used in performing this review. Review procedures included:

1. Reviewing general departmental information, policies and procedures, and Management practices for the department.

2. Conducting surveys and interviews with Executive Management and Audit Department staff.

3. Reviewing a representative sample of Audit Department work papers.

4. Identifying opportunities for improvement and developing recommendations on audit procedures and activities to enhance compliance with the Standards and improve existing processes.

<u>Quality Evaluation</u>
The results of the self-assessment indicate that the practices of the Audit Department continue to either fully or partially comply with the Standards in all areas. The IIA provides a system of rating the level of compliance with the Standards, which consists of three categories: "Generally Conforms", Partially Conforms", and "Does Not Conform".

In our opinion, the Audit Department activities at Metropolitan "Generally Conforms" to the Standards as confirmed from the assessment.

Continuous Audit Activities (Monthly Reviews)

<u>Inland Feeder Project</u>
Our review included agreeing actual costs reported to the Board to source documentation, including the general ledger, the Inland Feeder Project (IFP) Monthly Report, and selected contract payments; reviewing estimated costs at completion; analyzing changes in various cost components; and attending on-site meetings held to review actual costs and discuss current problems. These meetings included extensive discussions on the progress of obtaining pipe

hauling permits from the City of San Bernardino and the impact that these efforts have on project costs. We also reviewed the procedures designed to dispose of salvaged equipment to ensure the safeguarding of assets and the propriety of the processes. Our review did not reveal any material differences between reported amounts and supporting documentation.

In addition, our ongoing review procedures for potential claims, liability exposures, and other pending issues have been designed to track such items in accordance with applicable reporting requirements under Financial Accounting Standards #5 (Accounting for Contingencies). Accordingly, for all pending legal claims, we consulted with the Chief Financial Officer, IFP management, or General Counsel's Office to evaluate the magnitude of potential loss to Metropolitan. It should be noted that the IFP Project Manager reports on contractors' claims currently in litigation and other potential claim issues to the Board monthly.