



- **Internal Audit Report for January 2009**

## Summary

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Three reports were issued during the month:

- **Equipment Inventory Audit Report**
  - **Purchase Card (P-Card) Program Audit Report**
  - **Board Infrastructure – Butier Construction Managers Audit Report**
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## Discussion Section

This report highlights the significant activities of the Internal Audit Department during January 2009. In addition to presenting background information and the opinion expressed in the audit reports, a discussion of findings noted during the examination is also provided.

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## Equipment Inventory Audit Report

### Background

Metropolitan maintains its Equipment Inventory to track capital equipment that costs \$5,000 and over and has a useful life of at least five years (four years for vehicles). These inventory items represent equipment purchases that are not a component part of a fixed asset or a stationary facility. The Operating, Expensed and Capital Equipment Operating Policy Manual establishes policies and procedures for the purchase, recordation, and control over capitalized assets. The purchase of these assets is made through the operating equipment appropriation and general fund and is capitalized and depreciated.

For equipment purchases of less than \$5,000, the Operating and Expensed Equipment Manual defines the policies and procedures for the purchase and recordation of these assets. The purchase of these assets is made through the Operations and Maintenance Budget Fund under the Equipment Expensed account and is not capitalized.

Capitalized equipment or otherwise trackable equipment (equipment less than \$5,000 and determined as trackable for business reasons) need to be “bar coded” to provide ease of accountability and to ensure physical security. As of August 31, 2008, the net balance in the Equipment Inventory account was \$19 million.

### Opinion

In our opinion, the internal controls over management of Equipment Inventory 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, 2006 through August 31, 2008.

## **Comments and Recommendations**

### **REVIEW AND APPROVAL**

Review and approval controls are established to designate specific points in a process for formal reconsideration and authorization. Review compels a specified person to reconsider a transaction at a specified point in a process with a view toward change/revision. Approval operates as a triggering mechanism requiring authorization by Management-approved personnel prior to the next phase of the process. Review and approval controls serve to protect against unauthorized, inaccurate, or duplicate transactions/requests. For operating Equipment Inventory, supervisory review of the cycle count ensures the accuracy and completeness of Management reports. In addition, reviews of P-Card purchase transactions ensure adherence to policies and procedures with regard to limits on type of items purchased and proper tracking of operating equipment.

During our review, we noted two of seven expensed equipment purchases tested were not bar coded. Further review noted that both items were purchased utilizing the P-Card purchase method, and thus were not subject to the established asset acquisition standards. Accordingly, the Asset Coordinator worked with the designated custodians to bar code these items. We also noted that the cycle count results were not always reviewed prior to distribution. For example, we noted one of the eight cycle counts incorrectly reported the total of equipment inventory for one department, instead of the total of equipment inventory for the plant location.

We recommend that Management ensure purchases are reviewed for compliance with policies and procedures and institute a review of the cycle count report prior to distribution to ensure accuracy and completeness of the report.

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## **Purchase Card (P-Card) Program Audit Report**

### **Background**

The Purchase Card (P-Card) Program is a process whereby credit cards are issued to employees to purchase goods and services for Metropolitan. The P-Card Program serves to facilitate and expedite small purchasing transactions, and it reduces the number of invoices that need to be processed by the Accounts Payable Section. The P-Card Program also serves as a more secure purchase process in replacement for drafts and/or petty cash. There are 270 active P-Card cardholders in the P-Card Program and for the period of July 1, 2007 to August 31, 2008, there were 26,000 transactions totaling \$9.9 million expended utilizing this P-Card Program.

### **Opinion**

In our opinion, the accounting and administrative procedures over P-Cards 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 July 1, 2007 through August 31, 2008.

## **Comments and Recommendations**

### COMPLETENESS AND ACCURACY OF INPUT

For the P-Card database, cardholder limits and employment status should be updated whenever changes occur to ensure timely and accurate information, and to prevent against unauthorized access and use. During our review of the P-Card database and administrative procedures, we noted:

- One user was listed as having two P-Cards. Further review revealed that one of the cards had been cancelled; however, the database was not updated appropriately.
- Two recently terminated employees were identified as active cardholders. Additional review revealed that these cards had been cancelled, although the database was not updated.
- Three recently terminated employees' P-Card cardholders were not cancelled even though the employees had been removed from PeopleSoft. It should be noted that at the date of testing, all three cards had expired.
- We also noted that administrative records for P-Card cardholders could not be located (Example: cardholder agreements, card cancellations, and cardholder training).

We recommend Management establish procedures to ensure that the P-Card database is updated on a timely basis, and that Management conduct periodic tests to ensure compliance.

### COMPLIANCE WITH REGULATIONS

California Regulation §1602 requires that all entities pay “use tax” on items purchased out-of-state, if the seller does not collect California “use tax”, and if the entity uses, gives away, stores, or consumes the item in California. For Metropolitan P-Card purchases, Business Services and Accounts Payable are responsible to ensure compliance with these “use tax” regulations.

During our testing, we found that in 10 of 15 instances tested (67 percent) “use tax” was not accrued nor paid on out-of-state purchases. Furthermore, we could not locate documentation that explained or supported this decision. In addition, we could not locate evidence that a formal review was performed to identify potential transactions where “use tax” may be owed.

We recommend that Business Services and Accounts Payable resolve the noted discrepancies. In addition, we recommend that Management establish procedures to ensure that P-Card transactions are reviewed, and that all applicable taxes are paid.

### COMPLIANCE WITH ESTABLISHED POLICIES AND PROCEDURES

Our examination revealed instances of noncompliance to established policies and procedures. Specifically, we noted improper P-Card purchases for restricted items such as registration fees for seminars, and for inventory items. We also noted that one of the seven cardholders tested did not keep receipts of purchases made in accordance with the established retention policy. Finally, we

noted that 4 of the 30 P-Card transactions tested (13 percent) were recorded to the incorrect general ledger account. For example, we noted that two lodging/meals purchases were posted to the Utilities Charges account (4410080).

We recommend that Management remind personnel of the importance of complying with District policies and procedures. Further, we recommend Management conduct periodic reviews to ensure compliance.

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## **Board Infrastructure – Butier Construction Managers Audit Report**

### **Background**

Metropolitan's Infrastructure Reliability and Protection Plan (Plan) was initiated to evaluate risks and vulnerabilities to Metropolitan facilities and to identify cost-effective options to address those risks through rehabilitation, repair or replacement. As part of this Plan, staff conducted assessments of Metropolitan's treatment plants and desert conveyance system. These assessments have resulted in several rehabilitation projects on the Colorado River Aqueduct and individual improvement programs at each of Metropolitan's five filtration plants.

Accordingly, Metropolitan entered into a two-year contract with Butier Construction Managers (Butier), effective through December 2008, in an amount not to exceed \$1.6 million to provide construction management and inspection services for the Colorado River Aqueduct, siphons, transitions, canals and tunnels rehabilitation and improvements. As of August 2008, Metropolitan has paid \$950,000 to Butier under this agreement.

### **Opinion**

In our opinion, the accounting and administrative procedures over Infrastructure Reliability Program Agreement with Butier 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 December 2006 through August 2008.

Although this report expresses an acceptable opinion, concern is noted in the fact that certain charges included in the Butier billings could not be substantiated by underlying source documentation. Specifically, we noted that Butier billings for selected labor charges (\$656,000) were itemized in an Excel spreadsheet. However, they were not supported with timesheets and payroll reports such as payroll registers or certified payroll reports. 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 TO TERMS AND CONDITIONS OF THE AGREEMENTS**

Compliance with contractual requirements is necessary to ensure accurate accounting records, proper supporting detail, and adequate control over the administration of the agreements.

Compliance with the contractual terms and conditions also ensures that parties fully discharge their duties and obligations and exercise their legal rights associated with the agreements.

We reviewed Butier invoices totaling \$723,000 and tested the labor charges billed on these invoices for ten consultant employees and three subconsultant employees. We noted:

1. Although Butier's billings for selected labor charges (total \$656,000) were itemized in an Excel spreadsheet, they were not supported with timesheets and payroll reports such as payroll registers or certified payroll reports. This is in contrast to the Audit Section of the agreement that requires the consultant to maintain all supporting documentation.
2. Per diem charges (total \$2,850) billed for Butier's two subconsultant employees were not supported with written prior approval from the Agreement Administrator. This is in contrast to the Allowable Travel Expenses section of the agreement that requires the preapproval of per diem requests by the Agreement Administrator.
3. Labor Classification category (CRA Inspector) billed for Butier's three subconsultant employees (total \$34,392) was not identified in the fee schedule. This is in contrast to the Compensation Section of the agreement that requires the consultant to pay for services performed and costs incurred in accordance with the fee schedule.
4. Three of five (60%) Butier invoices tested were paid late, from four to eight days after their due dates. This is in contrast to the Billing and Payment Section of the agreement that requires payment within 30 days, after receipt of the invoice.

We recommend the Agreement Administrator resolve the noted differences. We also recommend that the Agreement Administrator establish procedures to ensure compliance to the terms of the agreements and conduct periodic reviews to ensure compliance. Furthermore, we recommend that Butier prepare and maintain adequate payroll documentation for labor charges billed to Metropolitan.

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## **Continuous Audit Activities (Monthly Reviews)**

### Inland Feeder Project

Our review included agreeing actual costs reported to the Board to source documentation, including the general ledger, the Inland Feeder Project 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, Inland Feeder Project Management, or General Counsel's office to evaluate the magnitude of potential loss to Metropolitan. It should be noted that the Inland Feeder Project Manager reports on contractors' claims currently in litigation and other potential claim issues to the Board monthly.