

Report

Office of the General Auditor

April 30, 2010



THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

• Internal Audit Report for April 2010

Summary

Three reports were issued during the month:

- **Company Housing Audit Report**
 - **Payroll Audit Report**
 - **KPMG Single Audit Report for Year Ended June 30, 2009**
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Discussion Section

This report highlights the significant activities of the Internal Audit Department during April 2010. 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.

Company Housing Audit Report

Background

Metropolitan Operating Policy J-10 (Conditions of Occupancy for Metropolitan Housing) states that “Metropolitan may provide reasonable dwellings, which meet accepted standards for family housing, for those Metropolitan employees whose job functions include the protection of Metropolitan facilities on a 24-hour basis. Housing may also be provided to other employees where it is determined that providing such housing is in the best interest of Metropolitan.” The Water System Operations Group manages Metropolitan housing and determines which employees live in these residences.

As of October 31, 2009, Metropolitan’s housing consisted of 140 homes, 11 in Los Angeles County, 44 in Riverside County, 84 in San Bernardino County, and 1 in San Diego County. Currently, 36 of these homes are vacant. Metropolitan housing inventory has decreased by 17 units since our prior audit in 2004, as Metropolitan has sold 7 homes and has demolished 10 other homes.

Rents on Metropolitan housing range from \$62 to \$152 per month and are calculated by multiplying the square footage of the home by a predetermined rate codified in Metropolitan’s Administrative Code. Electrical usage by renters is computed at a flat rate of \$0.005 per kilowatt hour and is billed on a monthly basis. Metropolitan also incurs repairs and maintenance costs on these facilities, although these charges are not currently billed to renters. The following table presents rent and electricity income, along with the repairs and maintenance costs for the past four fiscal years and for the current fiscal year through October 2009 (four months).

	FY 05/06	FY 06/07	FY07/08	FY 08/09	FY 09/10**	Total
Rent Income	\$109,375	\$112,016	\$119,772	\$99,765	\$30,293	\$471,221
Electricity Income	\$10,622	\$10,563	\$11,386	\$10,443	\$4,577	\$47,591
Repairs/Maintenance Costs*	\$70,114	\$73,579	\$41,804	\$122,484	\$81,299	\$489,280

* Includes labor, service and maintenance costs.

** From July to October 2009 (four months).

Opinion

In our opinion, the accounting and administrative procedures over Company Housing 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, 2004 through October 31, 2009.

Comments and Recommendations

COMPANY HOUSING

Metropolitan Operating Policy J-10 (Conditions of Occupancy for Metropolitan Housing) states that "Metropolitan may provide reasonable dwellings, which meet accepted standards for family housing, for those Metropolitan employees whose job functions include the protection of Metropolitan facilities on a 24-hour basis. Housing may also be provided to other employees where it is determined that providing such housing is in the best interest of Metropolitan." The majority of Metropolitan's homes are in the Desert Region, as part of the Colorado River Aqueduct conveyance and distribution system. Those homes were originally built because there were no communities within a reasonable distance of those locations (i.e., Gene Pumping Plant).

While Metropolitan housing was once held as a necessary and appropriate cost of delivering water to Southern California, the proximity of local communities to field locations and the automation of the water conveyance systems reduce the necessity of providing housing to Metropolitan employees. Metropolitan housing has resulted in unique community issues and minor personal disputes better suited to the training of peace officers. Metropolitan housing has also resulted in elevated repair and maintenance costs needed to maintain residences to changes in housing and building codes. Therefore, operating efficiencies could be achieved without undue hardship to employees, if Metropolitan housing were limited or eliminated.

As of October 31, 2009, Metropolitan's housing has consisted of 140 homes, 11 in Los Angeles County, 44 in Riverside County, 84 in San Bernardino County, and 1 in San Diego County. Currently, 36 of these homes are vacant. Metropolitan housing inventory has decreased by 17 units since our prior audit in 2004, as Metropolitan has sold 7 homes and demolished 10 other homes.

We encourage Water System Operations Group management to continue its efforts in eliminating (through the sale or demolition) Metropolitan housing down to a number that is appropriate to its business needs.

ELECTRICITY CHARGES BILLED TO RENTERS

The Memorandum of Understanding (MOU) between Metropolitan and its labor organizations sets forth, among others, the agreement of the parties with respect to employee salaries, working conditions, benefits, and Metropolitan housing. Compliance with the MOUs is necessary to ensure that parties fully discharge their obligations and exercise their rights. The Metropolitan Housing Section of the MOUs requires employees renting Metropolitan-owned residences to pay the utility charges commensurate with the local electricity rates in the area.

During our review, we noted that the flat rate of \$0.005 per kilowatt hour has not been evaluated since 1980 (30 years ago). Further review revealed that this rate is significantly lower (some 30 to 40 times) than the average electricity rates prevailing in Metropolitan's service areas. Conservative estimates reveal that a more fair and proper electrical rate would result in an annual increase of electrical income of \$250,000.

We recommend that Water System Operations Group management conduct a study of prevailing electricity rates at Metropolitan housing locations. We also recommend that Water System Operations Group management adopt the prevailing rates and apply these rates to future billing to renters.

Payroll Audit Report

Background

Administration of the Payroll process is shared by the Human Resources Group and the Controller Section. The Human Resources Group is responsible for establishing and maintaining employee records, securing the personnel and employee benefit files, and authorizing users and their rights in the PeopleSoft system. The Payroll Administration team of the Controller Section is responsible for reviewing payroll information entered into the WorkTech time system, and for processing payroll transactions through PeopleSoft.

As of November 14, 2009, Metropolitan had 1,923 employees: 1,867 were regular full-time employees, 4 were regular part-time employees, 16 were temporary full-time employees, and 36 were temporary part-time employees. Payroll expenses totaled \$7.4 million for the biweekly payroll period ended November 14, 2009.

Opinion

In our opinion, the accounting and administrative procedures over Payroll 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 April 21, 2007 through November 14, 2009.

Comments and Recommendations

FORMAL POLICY AND PROCEDURES – USER ACCESS TO PAYROLL DATA

Written policies and procedures should be established and documented to provide a framework for achieving compliance with applicable regulatory requirements, Metropolitan's policies, goals, and objectives. Procedures assist management in the training of new employees, provide guidance for consistent performance of daily responsibilities, and provide a source of reference for experienced personnel. User access policies ensure that sensitive information is used to perform legitimate business functions and is safeguarded from disclosure to unauthorized personnel.

Effective access control is achieved by limiting access to computer systems based on a periodic analysis of staff duties and responsibilities. Management should differentiate between the functions allowed, ranging from a "read only" capability for most employees, to a "write" capability for supervisory personnel.

During our review, we noted:

- Written policies and procedures that define job duties and corresponding access level to payroll data could not be located (e.g., Labor History Report, PeopleSoft).
- All employees have access to payroll data residing in the R: shared directory, 266 users with access to the Labor History Report within Employee Information System (EIS), and 114 users with access to PeopleSoft. It is important to note that some users have not accessed the Labor History Report since 2006.

We recommend that Human Resources management work with Information Technology Section management to establish a user access policy for granting/removing access to network stored data. We also recommend that Human Resources management perform periodic reviews of user access to ensure compliance.

PAYROLL RECORDKEEPING

The Federal Fair Labor Standards Act (FLSA) establishes minimum wage, overtime pay, and recordkeeping standards affecting full-time and part-time workers in the private sector and in federal, state, and local governments. The intent of FLSA was to eliminate the exploitation of unskilled production workers (e.g., manufacturing and farming industries) forced to work long hours for low pay following the Great Depression. FLSA also defined exemptions to these standards for certain individuals based upon their job duties, e.g., executive, administrative, and professional.

FLSA provides the guidelines upon which the classification of nonexempt and exempt is made, which in turn determines the employee's compensation structure of hourly versus salaried. This distinction is important, as nonexempt employees must be paid for overtime, while exempt personnel are paid on a salaried basis regardless of actual hours work. FLSA's recordkeeping requirements differ for nonexempt and exempt employees; that is, an employer must maintain actual hours worked for nonexempt employees, but only the time and day of week when the workweek begins for exempt employees. The Administrative Code § 6223 and Operating Policy C-07 - Timekeeping Procedures are consistent with FLSA provisions.

During our review, we noted an inconsistent practice for the recordation of exempt employees' work hours that appear to be inconsistent with the Administrative Code and Operating Policy. That is, some exempt employees record the number of hours worked daily and submit a leave request for the hours absent from work (partial day absence). Although requiring exempt employees to use paid leave to cover partial day absences is permissible under the FLSA, it is inconsistent with Administrative Code § 6223 and Operating Policy C-07, as currently drafted, which state that exempt employees are allowed to record eight hours for each workday and shall be paid for 40 hours each week on a biweekly basis regardless of actual hours worked or whether the week is a 44- or 36-hour workweek. Moreover, leave (annual, sick) is recorded only if it is a full workday or more, so long as the exempt employee continues to average at least 40 hours per week.

We recommend that Human Resources management establish procedures to ensure compliance with applicable labor laws and regulations, Metropolitan's policy and procedures, and labor agreements. We

also recommend that Human Resources resolve the noted discrepancies on exempt employees' leave accrual.

Additional Comments and Recommendations

We noted additional comments and recommendations during the course of the Payroll Audit. In order to effectively communicate these results to those charged with the duty to oversee the strategic direction of Metropolitan and to control operations, we presented the following to Ms. Debra Man, Chief Operating Officer, and Mr. Gilbert Ivey, Chief Administrative Officer:

PAYROLL RECORDKEEPING AND EMPLOYEE CLASSIFICATION

The Federal Fair Labor Standards Act (FLSA) establishes minimum wage, overtime pay, and recordkeeping standards affecting full-time and part-time workers in the private sector and in federal, state, and local governments. FLSA provides the guidelines upon which the classification of nonexempt and exempt is made which, in turn, determines the employee's compensation structure of hourly versus salaried.

During our review of the job classification structure, we noted apparent discrepancies between the attributes for certain nonexempt positions and the White-Collar Exemption Guidelines, as cited in Sections 13(a) (1) and 13(a) (17) of the FLSA. Specifically, we noted that 89 job titles currently classified as nonexempt have base salaries of at least \$100,000. However, this salary threshold is used as the basis for defining "highly compensated" employees in the White-Collar Exemption Guidelines, and provides the rationale for the employee to be classified by the FLSA as exempt, if the employee customarily and regularly performs at least one of the duties of an exempt executive, administrative, or professional employee.

The Code of Federal Regulations Pertaining to the U. S. Department of Labor, Title 29, Chapter V, Part 541, Subpart G states:

29CFR541.601 - Highly compensated employees

(a) An employee with total annual compensation of at least \$100,000 is deemed exempt under section 13(a)(1) of the Act if the employee customarily and regularly performs any one or more of the exempt duties or responsibilities of an executive, administrative or professional employee identified in subparts B, C, or D of this part.

This section further adds:

(c) A high level of compensation is a strong indicator of an employee's exempt status, thus eliminating the need for a detailed analysis of the employee's job duties. Thus, a highly compensated employee will qualify for exemption if the employee customarily and regularly performs any one or more of the exempt duties or responsibilities of an executive, administrative or professional employee identified in subparts B, C, or D of this part. An employee may qualify as a highly compensated executive employee, for example, if the employee customarily and regularly directs the work of two or

more other employees, even though the employee does not meet all of the other requirements for the executive exemption under Sec. 541.100.

The Code also defines executive, administrative, or professional employees:

29CFR541.100 - General rule for executive employees.

(a) The term ``employee employed in a bona fide executive capacity'' in section 13(a)(1) of the Act shall mean any employee:

(1) Compensated on a salary basis at a rate of not less than \$455 per week (or \$380 per week, if employed in American Samoa by employers other than the Federal Government), exclusive of board, lodging or other facilities;

(2) Whose primary duty is management of the enterprise in which the employee is employed or of a customarily recognized department or subdivision thereof;

(3) Who customarily and regularly directs the work of two or more other employees; and

(4) Who has the authority to hire or fire other employees or whose suggestions and recommendations as to the hiring, firing, advancement, promotion or any other change of status of other employees are given particular weight.

(b) The phrase ``salary basis'' is defined at Sec. 541.602; ``board, lodging or other facilities'' is defined at Sec. 541.606; ``primary duty'' is defined at Sec. 541.700; and ``customarily and regularly'' is defined at Sec. 541.701.

29CFR541.200 - General rule for administrative employees.

(a) The term ``employee employed in a bona fide administrative capacity'' in section 13(a)(1) of the Act shall mean any employee:

(1) Compensated on a salary or fee basis at a rate of not less than \$455 per week (or \$380 per week, if employed in American Samoa by employers other than the Federal Government), exclusive of board, lodging or other facilities;

(2) Whose primary duty is the performance of office or non-manual work directly related to the management or general business operations of the employer or the employer's customers; and

(3) Whose primary duty includes the exercise of discretion and independent judgment with respect to matters of significance.

(b) The term ``salary basis'' is defined at Sec. 541.602; ``fee basis'' is defined at Sec. 541.605; ``board, lodging or other facilities'' is defined at Sec. 541.606; and ``primary duty'' is defined at Sec. 541.700.

29CFR541.300 - General rule for professional employees.

(a) The term ``employee employed in a bona fide professional capacity'' in section 13(a)(1) of the Act shall mean any employee:

(1) Compensated on a salary or fee basis at a rate of not less than \$455 per week (or \$380 per week, if employed in American Samoa by employers other than the Federal Government), exclusive of board, lodging, or other facilities; and

(2) Whose primary duty is the performance of work:

(i) Requiring knowledge of an advanced type in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction; or

(ii) Requiring invention, imagination, originality or talent in a recognized field of artistic or creative endeavor.

(b) The term ``salary basis'' is defined at Sec. 541.602; ``fee basis'' is defined at Sec. 541.605; ``board, lodging or other facilities'' is defined at Sec. 541.606; and ``primary duty'' is defined at Sec. 541.700.

It is important to note that the FLSA guidelines also include considerations other than the “highly compensated” employee attribute when analyzing a job position for the exempt status. Criteria such as the timing and method used for payroll processing and the job duties of incumbents must also be met. An employer is questioned as to whether its employees are paid daily, weekly, or based on another formula.

With regard to fiscal management, we noted that overtime pay for five nonexempt classifications having base salaries of at least \$100,000, totaled \$685,000 during the 26 pay periods ended November, 14, 2009.

<u>Job Title</u>	<u>Overtime Paid</u>	<u># of Employees</u>
Engineer	\$456,178.34	46
Senior Programmer Analyst	\$98,556.53	26
Principal Administrative Analyst	\$24,192.66	13
Environmental Specialist	\$5,790.40	3
Senior Chemist	\$52.64	1
Total	<u>\$684,770.57</u>	<u>89</u>

It is important to note that these five classifications are represented by AFSCME, Local 1902. Pursuant to Section 5.10 of the Memorandum of Understanding between Metropolitan and AFSCME, all classifications in this bargaining unit are to be treated as FLSA “nonexempt,” and thus are entitled to overtime.

We recommend that executive management and the Office of the General Counsel conduct a study using FLSA guidelines to ensure that employees are properly classified as exempt/nonexempt. We further recommend that executive management implement appropriate changes to these job classifications, effective as of a date that is mutually agreed to with the affected bargaining unit(s).

KPMG Single Audit Report for Year Ended June 30, 2009

The Federal Single Audit Act of 1984, as amended by the Single Audit Act Amendments of 1996, requires state or local government units that expend \$500,000 or more of federal financial assistance in any one year to have an audit conducted for that year. The firm of KPMG, in accordance with generally accepted auditing standards promulgated by the American Institute of Certified Public Accounts, audits Metropolitan’s accrual basis financial statements. In the event that a so-called “Single Audit” is required to be conducted for a particular year, the cost of such an audit is included as part of the required audit services provided by that firm under its agreement with Metropolitan.

Due to the magnitude of federal sources and moneys expended during the fiscal year ended June 30, 2009, Metropolitan was required to have a Single Audit performed. KPMG performed the necessary auditing procedures and issued the following audit reports.

- 1. Internal Control over Financial Reporting and on Compliance and Other Matters.**
- 2. Compliance with Requirements Applicable to Each Major Program and Internal Control.**

These reports were distributed to the Board in April and were discussed at the April 27, 2010, Audit and Ethics Committee meeting.
