



Background

Summary

The General Auditor's business plan is designed to provide assurance that Metropolitan's internal controls are adequate to mitigate risks, governance processes are effective and efficient, and organizational goals and objectives are met. These goals are achieved by directing a properly trained staff of audit professionals with an understanding of the business culture, systems, and processes of Metropolitan.

Auditing Standards

The Office of the General Auditor adheres to the Institute of Internal Auditors' (IIA) *International Standards for the Professional Practice of Internal Auditing (Standards)* and *Code of Ethics*. The *Standards* provide the following definition of internal auditing:

"Internal Auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes."

We believe that the Office of the General Auditor complies with these *Standards*. In this regard, the IIA conducted an external assessment of the Audit Department in 2007 and reported that the department generally conforms to the *Standards*. The Office of the General Auditor's reporting line to the Audit and Ethics Committee establishes our independence. Our objectivity is maintained by an appropriate mind-set within the department, which is reinforced by training, policies, and auditor supervision. Finally, our internal audit activity evaluates Metropolitan's risk exposures related to:

- Effectiveness and efficiency of operations.
- Reliability and integrity of financial and operational information.
- Safeguarding of assets.
- Compliance with laws, regulations, and contracts.

We assess additional aspects of Metropolitan such as ethics and values, performance management, and communication of risk and control information in order to contribute to effective governance processes.

With regard to audit activities, our audit reports provide recommendations for improvement in those areas where deficiencies are identified. Furthermore, our stakeholders are requesting more clarity and the prioritization of audit results so that they know which issues require their immediate attention. We have worked diligently on meeting these expectations and in providing high quality audit reports by conducting periodic staff training coupled with ongoing coaching



emphasizing the importance of report writing skills. While Management is responsible for internal controls, the Audit Department provides assurance to the Board of Directors and Management that internal controls are effective and working as intended.

The cornerstone of the Audit Department's ongoing commitment to professionalism and improvement is the Quality Assurance and Improvement Program (QAIP), which encompasses all aspects of internal audit activities. This program helps the Audit Department add value and provides assurance that audit operations conform to the Audit Department's Charter, policies and procedures, and the *Standards* and *Code of Ethics*. The required elements of the QAIP include:

- Auditor training and professional development.
- Internal assessments comprised of both ongoing reviews (e.g. staff supervision) and periodic reviews assessing compliance with selected *Standards*.
- External quality assessments (performed every five years).

During FY 2009/10, we performed ongoing reviews and periodic assessments of the quality of Audit Department operations. Our ongoing reviews included audit supervision and work paper approvals; analysis of performance measures; semimonthly status meetings and reports; and General Auditor approval of all audit reports. Additionally, we are in process of performing a review assessing the quality and conformance to *Standards* of audit work papers, annual risk assessment and Audit Plan, and policies and procedures. We will complete this review in June and will share the results with the Audit and Ethics Committee at the next meeting.

Audit Department Goals

The Office of the General Auditor added value and helped improve operations by concentrating on the objectives approved by the Audit and Ethics Committee in June 2009. These Audit Department goals were:

- Provide risk perspective and auditing advice/counsel to the Board and Management on operational, financial, and governance activities.
- Deliver effective, high-quality, risk-focused audit reports designed to communicate the General Auditor's opinion regarding the internal control structure, identify significant audit issues, and present recommendations to mitigate noted risks.
- Manage completion time for audits and evaluate the adequacy and timeliness of Management's response to, and corrective action taken on, all significant control issues noted in audit reports.
- Emphasize test work of significant projects.
- Identify training opportunities for audit staff to enhance competencies in risk assessment and to broaden their knowledge of Metropolitan operations. Utilize this knowledge to fine-tune the Annual Audit Risk Assessment and Audit Plan.
- Find new ways to improve current performance through benchmarking and quarterly evaluation of the Audit Plan. Increase knowledge sharing and team processes.
- Effectively manage the department's budget.
- Uphold the mission, roles, and responsibilities of the Audit Department.



The following sections outline these goals and provide detail of achievements that were critical to our success during FY 2009/10. Some categories consolidate multiple goals, while others describe efforts that were not singled out as specific goals at the June 2009 Audit and Ethics Committee Meeting. While they were not identified as individual goals at the meeting, they were nonetheless integral to providing professional audit services to the Board.

Collaborate with BOD/Management to Design the Annual Audit Plan

Ensure that audits of critical operations and systems continue to be emphasized in the Annual Audit Plan. Update the Audit Plan based on a thorough assessment of risks coupled with input from key stakeholders. Allocate Audit resources to the highest risk areas in order to provide insight regarding Metropolitan's governance processes to the Board/Management and emphasize test work in significant areas.

Activities

1. Updated the audit universe of potential audits based on input from Board members, Management, external auditors and audit staff. Also, revised the list of potential audits to tie in with the General Manager's Business Plan.
2. Based on the audit opinions issued in the previous year and our evaluation of the reliability and effectiveness of Metropolitan's controls, reassessed the risk factors on a scale of 1 (Low Risk) to 5 (High Risk) for each potential audit. Therefore, the highest perceived risk areas received a risk score of 25. These risk factors continue to be: financial, political, legal/regulatory, operational, and auditor judgment.
3. Emphasized test work of significant projects. We allocated audit resources to the highest risk areas to develop the FY 2009/10 Audit Plan, which was presented to the Audit and Ethics Committee in June 2009.
4. Maintained continuous audit presence for higher risk projects (e.g. Inland Feeder Project, Oxidation Retrofit Projects, Perris Valley Pipeline Project, and the Quarterly Consulting Contracts Report).
5. Participated in thirteen Systems Development Life Cycle (SDLC) projects. These efforts involve review and evaluation, at various stages in the development of a selected system or large scale enhancement to an existing application. Audit tests include review of compliance with the systems development process and review of the controls being built into the system to ensure completeness, accuracy, data security, and proper authorizations.

Perform Quarterly Assessments of the Annual Audit Plan

Monitor progress against the Annual Audit Plan. Perform periodic assessments of the organization's risk profile and progress against the annual audit plan. Make adjustments as needed.



Activities

1. Conducted semimonthly Audit Staff meetings to assess progress against the Annual Audit Plan and to assist staff on complex audit technical issues. Assigned Principal Auditors (senior level auditor) to each staff auditor to aid in on-the-job training and to provide valuable coaching assistance.
2. Revised the Audit Plan to adjust for resource limitation due to an Audit Department staff vacancy, which we subsequently decided not to fill. Furthermore, responded to Assistant General Auditor's leave by modifying staff reporting, supervision, and review processes in order to provide sufficient audit supervision. Supplemented existing resources with external consultant who is a subject matter expert to perform the Human Resources review.
3. Performed quarterly assessments of the Department's performance against the Annual Audit Plan and adjusted the plan for changes in audit risk profiles, Board/Management requests, and emerging issues. Several Board or Management requested audits were added to the Audit Plan including the Transit Reimbursement Program, the Water Resource Management Conservation Program Review, and the Human Resources Review. It is important to note that lower risk audits were placed on hold in order to free up resources for these reviews. A brief description of the Conservation Program Review and the Human Resources Audit follows:
 - a. WRM Conservation Program Review - Based on the Board's request, a review of the Water Resource Management Group – Conservation Credits Program as of June 30, 2009 was completed. While this review began as an effort to validate the accuracy of the Board Letter request for additional funding for the rebate programs, it grew into a review of the events and circumstances that led to the need for additional funding. Accordingly, we reviewed the operational policies and business practices used by the Water Resource Management Group (WRM) to manage these programs. We also examined the associated agreements for the terms and conditions of these programs and to understand the circumstances by which these agreements could be terminated. Furthermore, we evaluated the financial controls over these processes by reviewing balancing and reconciliation procedures. We also examined operational controls that should ensure that the business processes are economical, efficient, and effective. Finally, we reviewed the management reporting process to ensure that rebate expenditure data was reported accurately and on a timely basis.
 - b. Human Resources Audit - Based on Management's request, a review of the business practices and operational policies of the Human Resources Group as of January 30, 2010 was completed. This review was conducted by Human Resource consultant Stan McKnight (from McKnight Associates, Inc.) in partnership with the Audit Department. Our audit consisted of an evaluation of services and functions that include recruiting services, classification and compensation services, employee and labor relations, equal employment opportunity, and workforce development.



These reviews could not have been completed without the cooperation Management and staff. Their willingness to discuss the challenges and issues facing the area under review was crucial to the completion of the audits. In addition, assistance from the Office of the General Counsel was critical to our completing these reviews on a timely basis. The synergism created by these joint efforts was responsible for making these reviews successful. We will continue to communicate with the Board regarding Management's progress in strengthening the control environment.

Continued Development & Supervision of Audit Staff

Ensure effective development and supervision of Audit Department staff. Provide training and coaching to ensure auditors continue to develop necessary professional and technical skills and are knowledgeable about emerging issues. Uphold the mission, roles and responsibilities of the Audit Department.

Activities

1. Conducted staff training during semimonthly Audit Department Staff meetings on a variety of topics including Audit Department Policies and Procedures, the *Standards* and the exchange of best practices from attendance at various professional education courses. Audit staff earned over 250 continuing professional education credits during the 2009/10 fiscal year by attending courses in areas such as auditing data reliability and performance management; computer assisted audit techniques; and assessing fraud risk. These sessions serve to remind staff of the importance of compliance to professional standards and they provide auditors with exposure to industry standards and emerging issues in these areas.
2. We continuously strive to improve core competencies, including work paper documentation and audit report writing. Consequently, we developed several tools in TeamMate to facilitate more efficient and standardized work paper documentation and to aid in the report writing/editing processes. Furthermore, we expanded our internal quality assessments to ensure continued progress in the area of work paper documentation.
3. Provided additional training to Audit Department Staff on a major upgrade to TeamMate software. These upgrades will increase auditor productivity by eliminating current manual processes.
4. Conducted further training on the Fraud Risk Primer Training and Awareness Program that was introduced to the Audit Department Staff last year. These discussions serve to remind staff of the auditor's role in assessing the risk of material misstatements due to errors of fraud, waste and abuse.
5. Utilized monitoring assignments such as Inland Feeder, Oxidation Retrofit, and Perris Valley Pipeline projects to develop auditors' consultative skills, and increase their operations knowledge while at the same time contributing their risk perspective to the team. In addition, auditors assigned to assist KPMG with the Annual Financial Audit were provided with the



external auditors' perspectives on risk assessment techniques, audit testing methodologies, and work paper documentation standards.

Perform Post-Audit Evaluations of Risk

Evaluate Management's response to the audit reports to ensure that the internal control structure has been improved (existing controls strengthened) or enhanced (new controls added). Perform verification tests of selected responses to confirm that changes made to controls achieve the intended purpose. Complete detailed review of Management responses for all audits that receive a "Less Than Satisfactory" or lesser audit opinion.

Activities

1. We recognize that our stakeholders are requesting more clarity and the prioritization of audit results so that they know which issues require their immediate attention. We have worked diligently on meeting these expectations and in maintaining high quality Audit Reports. Upon completion of the audit, we request a response from Management within 30 days of the issuance of the audit report.
2. Received timely responses (or a request for an extension) for all audit reports issued. Reviewed responses for propriety and completeness and noted no deficiencies.
3. Reviewed Management responses for the three audits receiving "Less Than Satisfactory" audit opinions during this fiscal year (Water Resource Management Program – Imperial Irrigation District/MWD Water Conservation Program; Sustainability of Water Supply – Consulting Agreements Bay Delta Issues; and Information Technology Consulting Agreements with CBH and Total Resource Management). Consulted with Management on the development of these responses and performed tests to ensure that control changes made are effective and efficient. We believe that Management's acceptance of these reports is the result of the "risk focus" of our audit process and of the quality of recommendations that assist Management in improving the internal control structure.
4. Audit reports with opinions continue to provide a number of significant benefits.
 - Help Board members and senior management assess audit results more quickly.
 - Provide the basis for prioritizing follow-up attention from the Board, Management, and/or the Audit Department.
 - Offer useful comparative information on the severity of issues or trends across the organization.

Contribute to Governance and Control Activities

Four major groups are involved in Metropolitan's governance process, including (1) the Board of Directors and the Audit and Ethics Committee, (2) Management, (3) operating staff and (4) the assurance group, which includes the Audit Department and external auditors. As noted previously, the



Audit Department adheres to the *Standards for the Professional Practice of Internal Auditing* set forth by the Institute of Internal Auditors (IIA).

Activities

1. The Audit and Ethics Committee ensures appropriate deployment of Audit Department resources by reviewing and approving the Audit Department's Annual Audit Plan and periodically reviewing its status. We successfully executed the FY 2009/10 Audit Plan that was presented to the Audit and Ethics Committee in June 2009. Major activities included:
 - Completed 30 audits with an additional 18 in progress that will be completed during the first quarter of the next fiscal year (2010/11). Audit activities for the year also included the issuance of 5 Comfort letters and 3 special projects at the request of the Board or Management. These special requests included the Transit Reimbursement Program, the WRM Conservation Program and the Human Resources Audit. Additionally, we assisted KPMG with the completion of the June 30, 2009 Annual Financial Audit. These results were achieved while we were revising our Annual Audit Plan to compensate for one unfilled audit position and the Assistant General Auditor's extended leave.
 - Devoted substantial effort to clearly communicate the issues that resulted in three "Less Than Satisfactory" audit opinions (WRM Program – IID/MWD Water Conservation, Sustainability of Water Supply Agreement Bay Delta Issues, and IT Consulting Agreements with CBH and TRM).
 - Responded flexibly with audit resources to emerging risk areas and requests of the Board and Management.
2. We conducted fraud risk training within the Office of the General Counsel staff to increase awareness of the nature, causes, and costs of occupational fraud and abuse. This program was designed to define fraud and identify the different types of occupational fraud that occur. It also discussed how and why fraud happens and described the controls that are used to mitigate these risks. The program also presented results from the 2008 Report to the Nation on Occupational Fraud & Abuse published by the Association of Certified Fraud Examiners. Finally, our Fraud Risk Assessment Program concluded that there were five things that organizations can do to minimize fraud risk:
 - Expect some level of fraud.
 - Look for it.
 - Be alert for Red Flags that warn of fraud risk.
 - Consider pre-employment screening for newly recruited.
 - Consider developing a Fraud Policy.
3. We conducted training sessions during the Contract Administration Workshop regarding Audit Evidence and Supporting Documentation. These classes explained the audit evidence gathering process and discussed the characteristics of sufficient, competent supporting documentation. Although the sessions concentrated on the invoice review process, we also presented a summary of our audit results from our contract audits conducted over the past 2 years. Moreover, we briefly



discussed fraud awareness and the Agreement Administrators' responsibilities to manage contracts in accordance with sound business practices. A more extensive Fraud Awareness presentation will be given at a future Contract Administration Workshop.

Performance against MWD Budget

We effectively managed Audit Department expenses within the approved budget. The Office of the General Auditor's FY 2009/10 actual expenses will be below budget, primarily due to the non-replacement of one auditor position and lower than budgeted training and travel expenses.

Teamwork across Functional Areas

We value input and feedback from our clients, and formally solicit input at two points during every audit: the Entrance Conference and the Exit Conference. We have found that setting the right tone of cooperation and professionalism during the Entrance Conference facilitates successful audit execution. Further, requesting management's insights into the risk profile of the audit area is an important element in our risk assessment process. Additionally, our Exit Conference provides an opportunity for audit clients to provide feedback regarding both the audit report and the audit process.

We generally receive positive feedback in the areas of effective communications, timeliness of the audit process, proficiency in technical matters, constructive approach, professionalism, and in providing a "value added" service. We are proud of this input and continually strive to improve our professionalism, technical audit abilities and client relationships.

Effectively Work With Board of Directors

We are highly committed to being a proactive, consultative audit department. We have responded to each request made by the Board or the Audit and Ethics Committee and have formed a cooperative relationship with Senior Management. While recognizing that our primary duty is to the Board, we endeavor to balance this duty with a supportive, advisory role with Management.