



Internal Audit Report for January 2012

Summary

Three reports were issued during the month:

- **Diemer Oxidation Retrofit - Shimmick/Obayashi Contract 1667 Audit Report**
- **Employee Usage of Company Property – Telecommunications Audit Report**
- **Audit Quality Assurance - Audit Plan Update**

Discussion Section

This report highlights the significant activities of the Internal Audit Department during January 2012. In addition to presenting background information and the opinion expressed in the audit reports, a discussion of findings noted during the examinations is also provided.

Diemer Oxidation Retrofit - Shimmick/Obayashi Contract 1667 Audit Report

Background

The Robert B. Diemer Water Treatment Plant (Diemer Plant) was placed into service in 1963 to treat water received primarily from the Colorado River. Currently, the Diemer Plant treats a blend of water from the Colorado River and the State Water Project, and delivers it to Orange County and parts of Metropolitan's Central Pool portion of the distribution system. The Diemer Plant had an initial capacity of 200 million gallons per day (mgd), and was expanded to its current capacity of 520 mgd in order to meet the demands from member agencies. In addition to these capacity expansions, Diemer Plant has had facility upgrades and improvements made throughout the years.

In March of 2002, Metropolitan's Board authorized preliminary design of both ozone and an alternative disinfection technology (e.g., chlorine dioxide) at the Diemer Plant to comply with Stage 1 of the U.S. Environmental Protection Agency's Disinfectants/Disinfection By-Products (D/DBP) Rule. In June 2004, the Board authorized final design of the Diemer Plant Oxidation Retrofit Program (Program), with the intention to make ozonation the primary disinfection process.

In July 2008, Metropolitan awarded \$188 million to Shimmick/Obayashi, a Joint Venture, to construct the Diemer Plant oxidation facilities. The addition of ozone will remove blend restrictions and substantially lower disinfection by-product level for compliance with Stage 1 and Stage 2 of the U.S. Environmental Protection Agency's D/DBP Rule. This is particularly important, as Metropolitan must begin monitoring and reporting compliance with Stage 2 of the

D/DBP Rule. The total cost of the Program at Diemer Plant is estimated to be \$373.5 million. Construction is expected to be completed by July 2012.

Opinion

In our opinion, the accounting and administrative procedures over Shimmick/Obayashi Construction Contract 1667 include those practices usually necessary to provide for a satisfactory internal control structure. The degree of compliance with such policies and procedures provided effective control for the period covering July 2008 to August 2011.

Comments and Recommendations

There were no material findings to report.

Employee Usage of Company Property – Telecommunications Audit Report

Background

Cellular telephones, personal digital assistants, and other electronic innovations have given Metropolitan increased access to employees, making those individuals more available and connected to their jobs. While technology has elevated employee efficiencies, these tools may provide the opportunity for workplace distractions and heighten the potential exposure to liability for employee acts. The Information Technology (IT) Section of the Business Technology Group has developed policies and procedures, including operating policies Telecommunications (I-06); Security of Computer Resources (I-01); Use of Computer Resources (I-02); and Procedures for Pagers, Cellular Devices, and Cellular Allowance. These policies provide guidance to users and set standards for telecommunication resources that include air cards, beepers and pagers, Blackberries, smart phones, cellular phones, cellular or cellular and data allowances, and desk telephones. As of June 30, 2011, Metropolitan’s employee and director telecommunication resources, allowances, and devices consisted of:

DESCRIPTION	NUMBER
Employee Allowances:	
Cellular Phone Allowances	165
Cellular Phone and Data Allowances	196
Employee Assigned Devices:	
Air Cards	68
iPads	4
Pool Cellular Phones	77
Pagers	261
Director Assigned Devices:	
Blackberries, Smart phones	21
iPads	19
Desk Telephones	2,895

Total telecommunication expenses for these devices totaled \$0.7 million for fiscal year 2010/11. Further, telecommunication expenses for the previous two fiscal years were:

DESCRIPTION	AMOUNT		
	FY 2008/09	FY 2009/10	FY 2010/11
Employee cellular, cellular and data allowances	\$250,600	\$353,100	\$358,900
Employee air cards, pool cellular phones, iPads, and director Blackberries and smart phones	237,200	139,500	113,000
Employee pagers	42,500	42,100	34,100
Director iPads service allowance	0	0	900
Desk telephones (estimated cost)	230,000	230,000	230,000
Total	\$760,300	\$764,700	\$736,900

Opinion

In our opinion, the accounting and administrative procedures over Employee Usage of Company Telecommunications Property 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, 2009 through June 30, 2011.

Comments and Recommendations

SAFEGUARDING COMPANY ASSETS

Compliance with established procedures is necessary to safeguard company property, preserve company resources, and protect against loss, theft, and negligence. Metropolitan's Operating Policy (I-06), "Telecommunications" and "Procedures for Pagers, Cellular Devices and Cellular Allowance" establish policies and procedures related to the administration, issuance, and cancellation of pagers and cellular devices. Our review of six invoices related to pager service revealed that invoices totaling \$2,925 were paid for equipment that was not returned. Further review revealed these charges related to 52 cancelled pagers that were not returned to the vendors.

We recommend that IT management remind users of their responsibilities to return unneeded devices to Metropolitan when cancelling service. Further, IT staff should follow up as necessary to avoid these charges in the future.

POLICIES AND PROCEDURES

Operating policies and procedures should be established and documented to provide a framework for achieving Metropolitan goals. Policies guide actions toward a desired outcome, whereas procedures assist management in the training of new employees or cross training of staff, provide guidance for consistent performance of daily operations, and provide a source of reference for

Metropolitan personnel. The IT Section has established policies and procedures, specifically Security of Computer Resources (I-01), Use of Computer Resources (I-02), Telecommunications (I-06) and Procedures for Pagers, Cellular Devices and Cellular Allowance to ensure proper usage of company equipment. During our review, we noted:

1. Although the aforementioned policies establish user guidelines, detailed “desk procedures” for IT Infrastructure staff responsible for telephone operations, including the operation of data circuits and telephone operations, should be established. These “desk procedures” should describe staff roles and responsibilities, as well as major daily tasks and processes used to manage and monitor telecommunications equipment.
2. Computer policies were not provided to directors upon issuance of Metropolitan owned iPads. While operating policies were explained by IT staff, this is in contrast to operating policies Security of Computer Resources (I-01) and Use of Computer Resources (I-02), which state that written operating policies are to be provided to users.
3. Although selected computer policies (Security of Computer Resources (I-01) and Use of Computer Resources (I-02)) apply to all users, Telecommunications (I-06) policy applies only to employees.

We recommend that IT management develop detailed “desk procedures” for data circuits and telephone operations to ensure communications operations’ processes and controls are not adversely impacted by employee turnover. In addition, we recommend that staff provide directors with applicable computer or telecommunications policies upon issuance of equipment. Lastly, we recommend that IT management revise Telecommunication Policy (I-06) to apply to all users.

RECONCILIATION OF TELEPHONE BILLINGS

Accounting control is achieved, in part by performing reconciliations of the accounting records. This activity provides assurance as to the propriety of the transactions affecting the accounts and helps identify potentially erroneous transactions. The IT Infrastructure Team should perform periodic reviews and reconciliations of telephone billings to validate the propriety of transactions. During our analysis of telecommunication expense trends, we were unable to locate reconciliations of telephone inventory and related telephone billings.

We recommend that IT management establish procedures to conduct periodic review and reconciliation of telecommunication costs and ensure compliance with these procedures.

Audit Quality Assurance - Audit Plan Update

In June 2011, the Audit and Ethics Committee and the Board of Directors reviewed and approved the fiscal year 2011/12 Audit Plan (Plan), which allocates resources to the areas of greatest perceived risk for Metropolitan. We recently evaluated the Audit Department’s performance versus the Plan for the first half of the fiscal year and noted that 21 audits, special reviews, and

“comfort letters” have been completed. Additionally, total resources for the half year (9,942 hours) were below Plan levels by 1,408 hours, primarily due to one open position which we have not filled for budgetary reasons. However, further analysis of Audit Department time charging for the quarter indicated a higher charge-out rate to projects of 53 percent, as compared with 51 percent in the Plan.

Lastly, in keeping with industry standards, we evaluated the Plan to identify significant changes in risk profiles or resource levels which could result in a recommendation to adjust the Plan. We do not believe such adjustment is necessary at this time, and we will continue to monitor risk and resources and provide formal updates on at least a quarterly basis.

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