



## **Internal Audit Report for August 2013**

### **Summary**

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Two reports were issued during the month:

- **Surplus Equipment and Personal Property Audit Report**
- **Federal Grants – Desalination Research and Innovation Partnership; California Friendly-Turf Replacement Incentive Program; and 2010 Storm Damage Project Audit Report**

### **Discussion Section**

This report highlights the significant activities of the Internal Audit Department during August 2013. In addition to presenting background information and the opinions expressed in the audit reports, a discussion of findings noted during the examination is also provided.

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## **Surplus Equipment and Personal Property Audit Report**

### **Background**

Our review consisted of evaluating the internal controls over the retirement and disposal of surplus equipment and personal property. We reviewed the retirement and disposal activities for compliance with Metropolitan's Administrative Code and operating policies. We also evaluated the recordkeeping procedures to ensure accurate accounting of auction and direct sale transactions, and to ensure proper removal of these items from the accounting records. Moreover, we evaluated the selection process for auctioneer services and recomputed commissions/fees paid for disposal services. Lastly, we evaluated physical controls over the custody of retired assets marked for disposal.

Metropolitan's Administrative Code Section 8271 (Disposal of Surplus Personal Property), Operating Policy F-02 (Disposal of Surplus Personal Property), and the Disposal of Surplus Personal Property Manual establish policies and procedures for the identification and disposal of surplus equipment and personal property (Surplus Property). Surplus Property includes operating equipment, tractors, trucks, automobiles, furniture, office machines, scrap, refuse, or stockpiled raw materials, including excavated material for which Metropolitan has no further foreseeable use. Operating policies and procedures authorize the disposal of Surplus Property through Web-based and live auctions, trade-ins with suppliers, recycling of equipment or material, and donations to outside entities.

The responsibility for the identification and disposal of Surplus Property has been assigned to the Administrative Services Section of the Business Technology Group. The Contracting Services Unit and the Inventory Management Team are responsible for authorizing the disposal of Surplus Property; whereas, the Investment Recovery Coordinator directs the sale of these items to auctioneers, direct buyers, and scrap dealers.

From January 2011 through April 2013, Metropolitan retired \$4.3 million (cost basis) of Surplus Property from its accounting system. During the same period, Metropolitan sold or auctioned 859 Surplus Property items, resulting in cash proceeds of \$340,000. Of this amount, \$197,000 (58 percent) related to the sale of vehicles, and \$64,000 (19 percent) related to the sale of trucks and tractors.

### **Opinion**

In our opinion, the accounting and administrative procedures over Surplus 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 controls for the period January 2011 through April 2013.

### **Comments and Recommendations**

#### COMPLIANCE WITH TERMS AND CONDITIONS OF AGREEMENT

Metropolitan's Surplus Property Disposal Service Agreement with General Auction Company (General Auction) requires signed acknowledgement confirming receipt of Surplus Property items such as vehicles, trucks, tractors, and office machines at time of pick up. In addition, Metropolitan's service agreement with Dick's Auto Wreckers (Wreckers) requires a weight certificate from a certified public scale to be submitted along with payment, within 30 days of scrap materials (metals) pick up. During our review, we tested all seven pick ups from General Auction and all three pick ups from Wreckers, and noted the following:

1. We could not locate evidence acknowledging receipt of surplus items by General Auction and Wreckers. It is important to note that Metropolitan's agreement with Wreckers did not include a provision for the receipt acknowledgement.
2. Wreckers did not provide weight certificates from a certified public scale for its pick up of scrap materials, in support of payments to Metropolitan.
3. Payments from Wreckers were received from 41 to 196 days, after the due date.
4. Metropolitan continued to have General Auction pick up and sell Surplus Property, after its contract expiration date of July 31, 2012.

We recommend that management remind its staff and business partners of the importance of complying with the terms and conditions of the agreements. We also recommend that management not authorize any services be performed by outside parties, without valid agreements to ensure that parties fully accept all important terms of the arrangement, including rights and obligations. Finally, we recommend that management perform periodic reviews to ensure compliance.

#### POLICY AND PROCEDURES

Policies and procedures should be written, reviewed, and updated periodically to reflect organizational changes and requirements, and to provide clear guidance to staff. Metropolitan's Operating Policy F-02 (Policy F-02) and the Disposal of Surplus Personal Property Manual (Disposal Manual) provide guidance for the identification and disposal of Surplus Property.

The Disposal Manual requires the custodian to submit a request on an Internal Shipment Packing List, and to obtain approval prior to disposing of an item. Operating Policy C-09, Remittance Handling/Processing, requires that all remittances be forwarded to Treasury and be accompanied by collection reports. During our review of 24 Surplus Property items, we noted:

1. We could not locate the Internal Shipment Packing List for retired assets 235599, 4528, 3599, and 240785. Further review revealed that one of these assets was cannibalized; whereby, its working parts were removed and used to repair another item. We also noted that the Disposal Manual does not provide instructions for asset cannibalization. This item is still recorded as an asset until Metropolitan performs a cycle count, and determines that it should be removed from the accounting records.
2. We could not locate evidence indicating approval for the identification and disposal of retired assets 242447, 225895, 14373, and 228319.
3. We could not locate evidence certifying that a safety inspection was performed by a fleet technician on retired vehicle 13449.
4. We could not locate collection reports for the remittances from the sale of surplus items 11975, 4568, and 3599. It should be noted that these checks were deposited promptly into Metropolitan's account.
5. We could not locate written procedures for ensuring that sensitive information is removed from computer hard drives, before disposition.
6. Policy F-02 and the Disposal Manual have not been updated since January 2006. They describe responsibilities for job titles and business functions that no longer exist in Metropolitan's current organizational structure. For instance, the responsibility of identification and disposal of Surplus Property has been assigned to the Administrative Services Manager of the Business Technology Group. However, the Disposal Manual includes this responsibility under the outdated title of Business Services Section Manager of the Corporate Resources Group. We understand that management has initiated efforts to update Metropolitan's Policy F-02.

We recommend that management remind staff of the importance of complying with established policies and procedures for the identification and disposal of surplus property. We also recommend that management formalize procedures for the cannibalization of surplus assets, and for the sanitization of computer hard drives prior to their disposition. In addition, we recommend that management review and update its Disposal Manual to reflect organizational or process changes, and to ensure clear guidance to staff. Finally, we recommend that management provide training to staff and conduct periodic reviews to ensure compliance.

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## **Federal Grants – Desalination Research and Innovation Partnership; California Friendly-Turf Replacement Incentive Program; and 2010 Storm Damage Project Audit Report**

### **Background**

Federal grants are economic aid issued by the government out of general federal revenue. These financial assistance awards are made to a grantee to carry out a public purpose or to stimulate economic activity authorized by law. In addition, federal awards can also be made to the State with local governments or other nonprivate entities receiving funds as a subgrantee. In these instances, program funds are administered through a coordinated effort between the federal agency, the State (grantee), and the subrecipient (subgrantee).

Federal grants have been awarded to the Water System Operations (WSO) Group and the Water Resource Management (WRM) Group. The WSO Group is responsible for the administration of grant awards for infrastructure reconstruction, due to natural disaster damages and water quality research projects. The WRM Group administers water planning and conservation grants.

In these instances, administrative duties include monitoring project activities, reviewing expenditures, approving reimbursement requests, and preparing management reports. In support of these activities, the Controller Section of the Chief Financial Officer is responsible for the accounting and administration of federal grants. In fulfilling these duties, the Controller established policies and procedures to support grant reimbursement requests, subrecipient payments, and the annual Schedule of Expenditures of Federal Awards. As of April 30, 2013, Metropolitan had 22 direct grants and 30 subrecipient grants totaling \$6.65 million and \$36.8 million. The following table lists the agency name, number of grants, and dollar amount for these grants.

AGENCIES	GRANTS	AMOUNTS
<b>Federal Grants Direct To Metropolitan</b>		
Federal Emergency Management Agency	14	\$3,900,000
United States Bureau of Reclamation	5	1,900,000
United States Environmental Protection Agency	3	850,000
Total	22	\$6,650,000
<b>Federal Grants To Metropolitan as Subrecipient</b>		
California Department of Water Resources	9	\$34,900,000
California Emergency Management Agency	15	1,200,000
Water Research Foundation	3	500,000
National Water Research Institute	1	150,000
Los Angeles County Sanitation District	1	30,000
American Water Works Association Research Foundation	1	17,200
Total	30	\$36,797,200

Our review focused on three grants including the Desalination Research and Innovation Partnership, the California Friendly-Turf Replacement Incentive Program, and the 2010 Storm Damage Project (Storm Project) grants. A summary of these grants follows:

- In 2007, the U.S. Environmental Protection Agency awarded the Water Quality Section of the WSO Group a grant of \$433,700 for the Desalination Research and Innovation Partnership Project. The objective of this grant was to develop membrane based technologies and treatment approaches to effectively desalinate degraded source water to provide safe drinking water.
- In September 2011, the U.S. Bureau of Reclamation awarded the Resource Implementation Section of the WRM Group a grant of \$1 million for the California Friendly-Turf Replacement Incentive Program (Program). The objective of this grant was to reduce water consumption, by using water-saving irrigations systems and California Friendly native plants. The Program’s goal was to transform 2,000,000 square feet of irrigated turf to California Friendly landscapes to achieve a water savings of 5,520 acre-feet, over a ten-year time period. Implementation of this Program was intended to contribute to the state’s goal of achieving a 20 percent reduction in per capita potable water use by 2020.

- In 2011, the Federal Emergency Management Agency (FEMA) awarded a grant to the California Emergency Management Agency (Cal EMA), which subsequently awarded a subgrant of \$1.15 million for the 2010 Storm Damage Project (Storm Project) to the Water Operations and Planning Section of the WSO Group. The purpose of this Project was to repair damage caused by 2010 winter storms, including restoring unpaved patrol and service roads, filling washout from around manhole structures, and implementing protective measures against high turbidity. This Project is currently awaiting final closeout.

### **Opinion**

In our opinion, the accounting and administrative procedures over the Federal Grants identified above 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 from July 2009 through April 2013.

### **Comments and Recommendations**

#### **COMPLIANCE WITH FINANCIAL REPORTING REQUIREMENTS**

Compliance with administrative requirements is necessary to ensure accurate accounting records, proper supporting detail, and adequate control over the administration of the agreements. Furthermore, compliance also ensures that parties fully discharge their duties and obligations, and exercise their legal rights associated with the agreements. For FEMA grants, the Office of Management and Budget (OMB) policies require recipients to submit quarterly financial reports to the FEMA Regional Director. These policies also require that subrecipients submit financial reports to the FEMA Regional Director, and to the grantee. During our review of the Storm Project grant, which Metropolitan participated as a subrecipient with Cal EMA, we noted inconsistencies in quarterly financial report filings. We could not locate evidence that financial reports were submitted to Cal EMA for three of five quarters tested. In addition, our review of the first and third quarter 2012 financial reports submitted to Cal EMA did not provide this grant.

We recommend management modify procedures to ensure that quarterly financial reports are submitted on a timely basis or obtain a release from the grantee in those instances that a financial report is not required. Further, we recommend management conduct periodic reviews to ensure compliance.

#### **COMPLIANCE WITH TERMS AND CONDITIONS OF THE AGREEMENTS**

Compliance with the terms and conditions of the agreements is necessary to ensure accurate accounting records, proper supporting detail, and adequate control over administering the agreements. In addition, compliance with the contractual terms also ensures that the parties fully discharge their duties and obligations associated with the agreements. For federal grant processing, policies and procedures require that grant reimbursement requests be accurate, properly supported, and billed on a timely basis. During our review of the Storm Project grant activity, we noted that reimbursement for eligible expenditures had not been requested. Although expenditures to repair the damage caused by the 2010 winter storms began in December 2010, a reimbursement request has yet to be submitted. Accumulated costs totaled \$942,072, and review of the work filed indicated that the Project is awaiting final closeout. Noncompliance with established terms and conditions of the agreement could result in losses to Metropolitan, if eligible expenditures were not billed to the grantee. Noncompliance has resulted in late reimbursement requests, and in the failure to properly close out completed grants.

We recommend that the WSO Group management work with the Controller Section to resolve the noted delinquency. We also recommend management modify procedures to ensure timely billing for eligible reimbursements, and conduct periodic reviews to ensure compliance.

#### PROJECT COMPLETION AND CLOSEOUT

Project management entails planning, organizing, and managing resources to bring about the successful completion of specific project goals and objectives. It involves monitoring and controlling activities from project initiation to closeout. Projects should be promptly closed after all contractual requirements have been met, all invoices have been paid, and Metropolitan has discharged all obligations. Our review of 14 FEMA projects revealed that Project 701677, completed in December 2005, has not been closed out. We understand that Cal EMA had identified this project as being closed in April 2012. This is in contrast to the Accounting and Administrative Procedures for Federally Funded Grants that requires the Federal Grant administrator to periodically review the status of projects to ensure timely closeout.

We recommend that Management modify procedures to ensure projects are closed out on a timely basis and conduct reviews to ensure compliance.

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