



## **Internal Audit Report for November 2013**

### **Summary**

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Three reports were issued during the month:

- **Workers' Compensation Program Audit Report**
- **Environmental Science Associates 106445, Integrated Design Services Group 116547, and Roctest Incorporated 118570 Audit Report**
- **FY 2012/13 Consulting Contracts Report Review**

### **Discussion Section**

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

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## **Workers' Compensation Program Audit Report**

### **Background**

Workers' compensation is a form of insurance that provides for wage replacement and medical care when an employee is injured in the course of employment, in exchange for the mandatory relinquishment of the employee's right to sue under general liability. Benefits received under these circumstances are governed by the State of California workers' compensation laws by way of standards that establish payments related to medical care and for temporary or permanent disabilities. Moreover, California law requires that employers maintain workers' compensation insurance against such occurrences. However, in 1979 the California Department of Industrial Relations granted Metropolitan the authority to self-insure its workers' compensation risk. Accordingly, Metropolitan self-insures the first \$5 million per claim and supplements this with excess insurance coverage of \$50 million.

Under Metropolitan's workers' compensation program, employees are entitled to receive medical treatment for job related injuries or illnesses and may be eligible for up to 104 weeks of temporary disability benefits. Payments for disability benefits begin after an employee is hospitalized overnight or unable to return to work within three days of an incident.

Management of this program is shared by the Human Resources Group (HR) and a third party administrator (JT2). The HR Group is responsible for reviewing the employee's injury report, facilitating submission of the claim to JT2, and coordinating the initial medical treatment for the employee. Under their agreement, JT2 is responsible for reviewing and investigating all claims, estimating the workers' compensation liability, and issuing indemnity and medical payments. Finally, HR staff reviews claims handling and payments, and assesses the liability reserve calculated by JT2.

Total workers' compensation payments made during FY2011/12 were \$1.3 million and were \$1.7 million for FY2012/13. Moreover, as of June 30, 2012 there were 97 open workers' compensation cases and Metropolitan had established a reserve of \$3.0 million. Further, as of June 30, 2013 there were 96 open workers' compensation cases and an associated reserve of \$2.8 million was established.

### **Opinion**

In our opinion, the accounting and administrative procedures over the Workers' Compensation Program (Program) 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 2011 through June 2013.

### **Comments and Recommendations**

#### REVIEW AND APPROVAL

Review and approval controls are designed to verify the accuracy of billings for goods and services, provide assurance as to the propriety of transactions, confirm compliance with contractual terms and conditions, and ensure that follow-up procedures exist for exception processing. The reviewer and/or approver should review invoiced items for propriety and agree them to source documentation for accuracy. For the Workers' Compensation Program, the third party claims administrator (JT2) verifies the indemnity and medical billings for propriety and accuracy, and ensures the completeness of supporting documentation prior to payment. The HR Group Workers' Compensation staff oversees JT2's claims payment process and performs a limited review of indemnity and medical billings and supporting documentation.

We reviewed 40 indemnity and medical payments totaling \$870,000 that were processed between July 2011 and June 2013. Our tests revealed that Metropolitan staff does not review JT2's medical payments that are less than \$5,000. Further review revealed that JT2 issued 3,316 checks for medical payments that were less than \$5,000 during this period. Moreover, these medical payments totaled \$1.6 million and represented about 45% of the total indemnity and medical payments issued during the two-year period.

We recommend that Workers' Compensation Unit management consider performing data analytics and judgmentally based sample testing on the medical payments less than \$5,000. The analytics would stratify the data and search for unusual patterns in the raw data. In addition, judgmental sampling techniques would test transactions below the \$5,000 threshold which would provide greater assurance as to the propriety and accuracy of workers' compensation payments.

#### SEGREGATION OF DUTIES

Prudent business practices suggest that the functions of initiating/recording incidents (injuries), executing/reviewing workers' compensation related activities, and authorizing payments/signing checks should be segregated to ensure adequate controls over the workers' compensation process.

Our review of twenty workers' compensation claims revealed that eleven incident reports were received and entered into the Incident Reporting System by the Workers' Compensation Unit rather than by the Risk Management Unit, as required by Metropolitan's Operating Policy E-3 "Incident Reporting." Moreover, the individual who recorded these incident reports was also responsible for coordinating claims with the third party administrator, authorizing indemnity/medical payments, and signing checks of \$5,000 or more.

We recommend that management implement procedures so as to ensure the responsibilities of administering the program, recording incident reports, and signing indemnity or medical checks are properly segregated.

## CASH RECEIPTS AND DEPOSITS

Prudent financial practice dictates that negotiable instruments should be afforded adequate and proper custody and control at all times. This control or safeguarding is achieved through a combination of accounting procedures and physical security controls. Examples of such procedures include the timely recordation of receivables, physical safeguarding of checks received in the mail and immediate processing/depositing of check receipts.

Our review of insurance company remittances revealed that four checks totaling \$508,539 were received by the treasurer from 7 to 61 days after the checks were issued. Further review revealed that subrogation funds or excess insurance payments are held by our third party claims administrator (JT2) until month-end before sending them to Metropolitan.

We recommend that management develop procedures to ensure that insurance company remittances received by JT2 are forwarded to the treasurer in a timely manner. We also recommend that management conduct periodic reviews to ensure compliance with these procedures.

## SUCCESSION PLANNING (Repeat Comment)

Succession planning recognizes that maintaining continuity following employee turnover is an important element of control. Succession planning also involves identifying key positions and formulating strategies to ensure that processes and controls will not be adversely impacted by employee turnover in order to ensure that goals and objectives are realized.

During our review, we noted that one full-time staff is responsible for managing the Workers' Compensation Program, including administration of the agreement with the third party claims administrator. However, we noted that this position is not supported by backup or cross-training to ensure that the workers' compensation process will not be disrupted due to staff absence, transfer or separation.

We recommend that management develop plans for backing up this position and ensuring effective succession planning.

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## **Environmental Science Associates 106445, Integrated Design Services Group 116547, and Roctest Incorporated 118570 Audit Report**

### **Background**

In order to ensure reliable high quality water supplies, Metropolitan performs ongoing studies and inspections of its conveyance and distribution system, treatment plants and other operational facilities. These studies can affect the repair and maintenance schedule and often result in changes to the capital investment plan.

Moreover, the Engineering Services Group enters into professional services agreements with consultants to supplement in house resources and provide specialized skills to complete these tasks.

Our review consisted of three separate consulting agreements, the first of which involved the Joseph Jensen Water Treatment Plant. The Jensen plant was placed into service in 1972 with an initial capacity of 350 million gallons per day (mgd) and was expanded in the early 1990s to its current capacity of 750 mgd. As part of the Jensen plant's water treatment process, residual solids were thickened on-site and then air-dried at the Los Angeles Department of Water and Power (LADWP) facilities through a cooperative agreement with

LADWP. Since the agreement with LADWP was set to expire in 2014, Metropolitan's Board authorized the preliminary design of a permanent solids handling facility at the Jensen plant in April 2004. Accordingly, in September 2008 Metropolitan's Board authorized an agreement with Environmental Science Associates (ESA) in an amount not to exceed \$418,000 for the environmental impact report related to the design of a dewatering facility along with a series of lagoons for air drying residual solids. Payments to ESA from agreement inception through September 2013 totaled \$343,144.

The second consulting agreement involved the periodic inspections, studies, and measurements made to evaluate the seismic stability of Metropolitan's infrastructure in earthquake prone areas. This contract evaluated infrastructure within the Upper Feeder portion of the conveyance and distribution system. Specifically, it contracted for work on the 1,010 foot long steel bridge that spans the Santa Ana River in an area known to have multiple active earthquake faults. These faults are believed capable of generating a 7.5 magnitude earthquake, which could damage the bridge and result in an extended shutdown of the Upper Feeder.

Moreover, in 2007, following staff's inspection of the bridge and the identification of corrosion and deterioration, Metropolitan's Board authorized preliminary design of structural upgrades for the bridge. In December 2010, Metropolitan contracted with the Integrated Design Services Group (IDS Group) for preliminary design activities including performing seismic analyses, evaluating retrofit options, and preparing a preliminary design report. This agreement is capped at \$150,000 per year for three years. Payments to IDS Group from agreement inception through September 2013 totaled \$388,934.

The third contract involved the Garvey Reservoir in the city of Monterey Park. This facility is part of the conveyance and distribution system whereby treated water is conveyed from the F.E. Weymouth Water Treatment Plant to the Garvey Reservoir where it is stored until distribution to the Central Pool area. However, in 1989, seepage at the Garvey Reservoir was observed due to damage from an earthquake and the reservoir was taken out of service for repairs.

In 1993, a settlement agreement with the city of Monterey Park was negotiated that required Metropolitan to provide Monterey Park with daily groundwater level and seepage measurements. Subsequently, an Automated Data Acquisition System (ADAS) of automatic sensing monitors, recording and telemetry equipment was installed to perform these measurements. Furthermore, in June 2011 the Board authorized an agreement with Roctest Incorporated (Rocrest) in an amount not to exceed \$404,390 to replace the ADAS because it was beginning to deteriorate and provide unreliable data. Payments to Rocrest from inception through March 2012 totaled \$404,390.

### **Opinion**

In our opinion, the accounting and administrative procedures over the consulting agreements with ESA, IDS Group, and Rocrest 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 January 2010 through September 2013.

### **Comments and Recommendations**

There were no material findings to report.

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## **FY 2012/13 Consulting Contracts Report Review**

### **Scope and Purpose of Review**

We reviewed the quarterly report for consulting and professional service agreements (Quarterly Report) published by the Professional Services Contracting Team for the fourth quarter (Annual) FY 2012/13. The purpose of this review is to gain reasonable assurance that information included on the quarterly report is accurate, complete and timely, and in compliance with the Metropolitan Water District Administrative Code.

### **Background**

Administrative Code Section 2720(a) "General Manager's Quarterly Reports" requires that the General Manager report to the Engineering and Operations Committee on the employment of any professional and technical consultant, the extension of any professional and technical consulting agreement, and on the exercise of the General Manager's authority under Section 8121(c) "Professional and Technical Consultants" and Section 8122(h) "Travel" during the preceding calendar quarter. The report covering the last calendar quarter of the year may be combined with and included in the annual report. Each report shall indicate when a consultant is a former employee of Metropolitan.

During fiscal year 2012/13, the amount paid for consulting and professional services totaled \$42.6 million. This amount includes \$41.0 million paid on agreements administered by the Department of the General Manager and \$1.6 million paid on agreements administered by the Legal Department. It should be noted that the totals reported under the General Counsel's authority are substantially less than prior periods as legal payments related to the San Diego County Water Authority litigation have been transferred to the Self-Insurance Retention Fund. In addition, the General Manager reported 415 active agreements with 86 terminations and the Legal Department reported 47 active agreements with 2 terminations.

### **Testing Procedures Performed**

Our procedures included cursory review of the reasonableness of professional services expenditures and consultants with multiple active agreements to determine whether an agreement was split into smaller agreements to override established approval authority limits. We also evaluated whether statistics in the report were adequately supported.

### **Testing results**

Our review did not reveal any contracts which appeared to be unreasonable or split to avoid established approval authority limits. In addition, our review did not reveal any material differences between the reported amounts and supporting documentation.