



Audit Department Report for February 2014

Summary

Four reports were issued during the month:

- **Procurement Card Program Audit Report and Management Response**
- **Consulting Agreements Less Than \$250,000 Audit Report**
- **Quarterly Consulting Contracts Report Review**
- **Official Statement for the Water Revenue Refunding Bonds, 2009 Authorization, Series A2**

Discussion Section

This report highlights the significant activities of the Audit Department during February 2014. In addition to presenting background information and opinions expressed in the audit reports, a discussion of findings noted during the examination are also provided.

Procurement Card Program Audit Report and Management Response

Background

Our review consisted of an evaluation of the administration of the Procurement Card (P-Card) Program. We tested issuance of P-Cards, compliance with cardholder agreements and Metropolitan's policies, and reviewed deactivation processes for transferred or separated employees. In addition, we also reviewed P-Card monthly statements and traced selected transactions to the documentation to test the propriety and accuracy of charges. Lastly, we performed analytical procedures of transactions designed to search for unusual data patterns, or for anomalous entries.

A P-Card is a form of a company charge card that allows goods and services be procured, without using the traditional purchasing process. Employee use of these P-Cards facilitate and expedite small purchasing transactions, reduce the number of invoices processed by Accounts Payable, and replace the use of cash drafts or petty cash disbursements. As of August 31, 2013, there were 267 cardholders with varying spending limits and merchant category code restrictions. P-Card purchases totaled \$8.9 million, \$8.4 million, and \$8.9 million in fiscal years 2010/11, 2011/12, and 2012/13, and averaged 58,845 transactions per year. Metropolitan processes its P-Card transactions through Bank of America, and utilizes the P-Card Web Solution system to track purchases and reconcile payments. The Contracting Services Unit (CSU) in the Business Technology Group administers the P-Card Program.

In particular, CSU's P-Card administrator oversees P-Card Program activities, reviews cardholder purchases and use tax accruals, performs analysis of cardholder accounts, and monitors reconciliations of monthly statements. Individual cardholders are responsible for ensuring the physical security of P-Cards, maintaining supporting documentation for purchases, providing purchase and merchant coding for transactions, reconciling monthly statements, and reporting lost cards to CSU.

Opinion

In our opinion, the accounting and administrative procedures over the P-Card Program provide for a less than satisfactory internal control structure. This opinion is the result of the failure during FY 2012/13 to obtain preapproval for restricted P-Card purchases of \$995,077, casual use of expenditure code classifications

resulting in \$1.5 million (17 percent of total) of expenditures being coded as Miscellaneous or Other, and the fact that \$2,277 of sales use tax for selected out-of-state purchases was not paid.

In addition, we are concerned the P-Card Web Solution database was not updated for P-Card cancellations on a timely basis, and we noted that procedure checklists were not always utilized to assist in reconciliations of P-Card holders (cardholders). These checklists track P-Card cancellations, renewals, suspensions, lost cards, and replacements. Our review focused on the period between July 1, 2010 and August 31, 2013. It should be noted that P-Card Program management has initiated remedial actions in response to our concerns. Management is updating the Operating Policies and Procedures Manual, and has assigned staff to conduct periodic compliance reviews, analysis, and reporting of P-Card activities. We will continue to assist management in the evaluation of solutions to these internal control structure concerns.

Comments and Recommendations

REVIEW AND APPROVAL

Review and approval controls serve to protect against unauthorized, inaccurate, or duplicate transactions; identify potential erroneous entries; and describe follow-up procedures for exceptions. For P-Card activity, these controls serve to ensure transactions are reviewed for propriety; supported by sufficient, competent documentation; and confirm expenditures are charged to the proper expense category. In addition, a cardholder’s P-Card activity should be reviewed periodically by someone independent of the cardholder. These controls are particularly important, as Metropolitan has started to use P-Cards as a strategic form of payment for goods and services. That is, the P-Card Program does not confine the purchasing activity to the traditional spending of low-dollar, high-transaction goods and services. P-Card purchases also include off-contract, nontraditional, non-purchase order, ad hoc, and incidental purchasing. Accordingly, Metropolitan has implemented controls for P-Card use; for example, single purchase dollar limits, a monthly limit, and merchant category code restrictions.

Our review of 30 selected P-Card transactions revealed that six transactions totaling \$11,035 were coded to inappropriate expense subaccounts, and three transactions totaling \$9,506 lacked supporting documentation. In addition, we performed analytical procedures of P-Card transactions designed to search for unusual patterns in the data or for anomalous entries. Our cursory analysis did not reveal any unusual items or personal purchases; however, we noted that \$995,077 (11.2 percent) of total FY 2012/13 P-Card purchases were for restricted purchases that lacked sufficient documentation to support preapproval by management, or were for miscoded purchases. Details of these purchases are as follows – NOTE: Percentages shown are a percent of total P-Card purchases:

FY 2012/13 RESTRICTED P-CARD PURCHASES

Item	Restricted Expense Category	Transactions	Amount	P-Card Purchase %
1	Transportation	2,394	\$335,921	3.8%
2	Meals and Lodgings	688	170,108	1.9%
3	Computers/Hardware/Laptops/Monitors	580	168,099	1.9%
4	Safety Items	738	153,215	1.7%
5	Registration Fees for Seminars	223	106,775	1.2%
6	Computer Software	159	58,091	0.7%
7	Automobile Fuel	3	1,495	0.0%
8	Postage Items	61	1,373	0.0%
	Total	4,846	\$995,077	11.2%

In addition, our review revealed that \$1.5 million (16.9 percent) of total P-Card purchases were coded or classified as Miscellaneous (\$1.4 million), or Other (\$122,000). Lastly, our review revealed that 26 of 263 cardholders had less than 10 transactions in FY 2012/13.

Lack of supporting documentation for P-Card transactions and failure to preapprove restricted transactions could result in financial loss to Metropolitan due to unauthorized, fictitious, or fraudulent transactions. Failure to encode or classify P-Card transactions to appropriate expense subaccounts could result in inaccurate program costs and management reporting.

We recommend that P-Card Program management and cardholders' management remind staff of the importance of complying with established policies and procedures, specifically management preapproval for restricted purchases and proper coding of transactions to the correct general ledger accounts. We also recommend that CSU staff perform random reviews of P-Card transactions to ensure compliance. Lastly, we recommend that P-Card Program management evaluate the need for cardholders where annual activity is low and consider cancelling the associated P-Cards.

POLICIES AND PROCEDURES

Compliance with established policies and procedures is necessary to provide accurate accounting records, proper supporting detail, and adequate control over accounting records. Policies and procedures provide the framework for accomplishing Metropolitan's goals, and achieving consistent results. Policies and procedures should be reviewed and updated periodically to reflect organizational changes/needs, and to provide clear guidance to staff.

Our review of 24 selected P-Cards revealed that in two instances the P-Card Web Solution (PCWS) database was not updated to reflect P-Card cancellations in January 2013 and June of 2013. Further review of 12 cancelled P-Cards revealed the P-Card administrator did not complete the required procedure checklists (i.e., loss, cancellation, renewal, suspension, and replacement). Additionally, we could not locate Incident Reports and written notifications for four lost P-Cards and the Separation Asset Retrieval forms for six separated employees. It is important to note that no financial losses resulted from these deficiencies. In addition, we could not locate the following P-Card Program reports and documentation:

1. Monthly activity reports, as required by the P-Card Procedure Manual.
2. Current cardholder list that should be provided to the Controller and Human Resources.
3. Written notifications file for lost P-Cards.
4. Documentation for random audits performed by P-Card Program management.
5. Documentation for management approval of restricted P-Card purchases.

Finally, although the P-Card Procedures Manual was issued in December 2012, we noted that Operating Policy C-05, Metropolitan Credit Cards, was last updated in April 2008 and does not reflect current responsibilities and business functions.

Failure to update the PCWS database for cardholder information could result in the processing of improper or fraudulent transactions. Financial loss could also occur, if a former employee used a P-Card that was not cancelled on a timely basis. Finally, failure to comply with policies and procedures could result in inaccurate accounting records, incomplete supporting documentation, or loss to Metropolitan from unauthorized transactions.

We recommend that P-Card Program management remind personnel of the importance of complying with established P-Card cancellation, renewal, or replacement procedures. Moreover, we recommend that management update the P-Card Procedures Manual and Operating Policy C-05, Metropolitan Credit Cards. Finally, we recommend that management inform and train cardholders and approvers on current policies and procedures and conduct periodic reviews to ensure compliance.

COMPLIANCE WITH USE TAX REGULATIONS

The California State Board of Equalization Publication 217 requires that all entities pay use tax on items purchased outside the state, if the seller does not collect California use tax and if the entity uses the items in California. The P-Card administrator and the Accounts Payable coordinator should ensure that P-Card purchases outside the state comply with California use tax regulations.

Our review of 30 P-Card transactions revealed that use tax of \$45 was not paid on one out-of-state purchase. Further review of 25 out-of-state purchases (\$26,054) on the No Sales Tax Report for FY 2012/13 revealed that use tax of \$2,232 was not paid in nine instances. Failure to comply with use tax regulations could subject Metropolitan to penalties and interest.

We recommend that the P-Card administrator and Accounts Payable manager resolve the noted discrepancies. In addition, we recommend that management establish procedures to ensure that P-Card purchases outside the state are reviewed, and that all applicable taxes are paid.

PURCHASE DISCOUNTS

Purchase discounts are often available to a buyer for paying an invoice within a prescribed time period, or for purchasing items in large quantities. These incentives profit the seller as they help move low-priced products in high quantities, and they form a stronger bond with the purchaser. Buyers benefit from these programs by reducing the costs of goods purchased, and they help ensure that the buyer is obtaining competitive pricing from suppliers. Purchase discounts should be negotiated as often as possible to ensure that the best price is obtained for goods and services.

Our analytical review of FY 2012/13 P-Card transactions revealed that \$2.0 million or 22 percent of total purchase volume (\$8.9 million) was procured from ten vendors (total 4,000 vendors). Moreover, we noted that purchase discount contracts were in place for only four of these vendors. Anecdotally, these discounts ranged from 5 percent to 30 percent. Failure to take advantage of purchase discounts where available represents an opportunity cost that could be avoided, if more resolute contract negotiations were conducted.

We recommend that Contracting Services Unit management emphasize the negotiation of purchase discounts whenever possible.

Consulting Agreements Less Than \$250,000 Audit Report

Background

The Audit Department has completed a review of the accounting and administrative controls over four professional consulting agreements less than \$250,000 managed by the Water System Operations (WSO) Group, as of November 30, 2013.

We reviewed agreements with Hatfield & Dawson Consulting Engineers, LLC 109712 (Hatfield & Dawson); Ninyo & Moore Geotechnical and Environmental Sciences Consultants 121218 (Ninyo & Moore); Process Applications, Incorporated 121496 (Process Applications); and Industrial Hygiene Management, Incorporated 130345 (Industrial Hygiene).

The Water Operations and Planning Section administer the Hatfield & Dawson agreement, Water Quality Section administers Process Applications agreement, and Operational Safety and Environmental Services Section administer Ninyo Moore and Industrial Hygiene agreements. Our review consisted of evaluating the internal controls over the consultant selection process, reviewing agreement administration practices, and testing compliance with the terms and conditions of the agreements. In addition, we evaluated the validity and propriety of invoice payments for assurance that amounts billed were properly calculated and adequately supported.

The WSO Group manages complex and comprehensive capital improvements programs, as well as operations and maintenance projects that total over \$200 million annually. These efforts require effective project management practices that ensure successful completion of the project plan. These practices involve the exercise of responsibility and decision-making about a project, authority to execute the project, and accountability to deliver project results within agreed-upon expectations, commitments, and constraints. These plans often require the project manager supplement existing construction, or consulting contracts with additional support services to ensure projects are completed timely and within budget. Accordingly, the WSO Group prequalifies consultants through the Request for Qualifications (RFQ) and Request for Proposals (RFP) processes for consideration in those instances where the need for technical support is acute.

Consultants are selected from the prequalification list and Metropolitan executes roll over agreements up to five years, with a maximum amount payable per agreement year. It is important to note that prequalification does not guarantee a consultant an agreement. That is, Metropolitan reserves the right to enter into an agreement with one or more consultants based upon project needs. Administrative Code Section 8121(c) grants authority to the General Manager to execute these professional and technical agreements without prior board approval, if amount payable during any one agreement year does not exceed \$250,000. As of November 30, 2013, Metropolitan had 230 active professional agreements each with contract amounts less than \$250,000 per contract year, or throughout the contract term. The maximum amount payable for these agreements totaled \$28.2 million through November 30, 2013.

In September 2009, Metropolitan issued RFP 925 to provide radio frequency engineering services for Phase II of the two-way radio system upgrade. Specifically, RFP 925 called for the design and implementation of recommendations from the Phase 1 study of the existing radio system, including upgrading to an Ultrahigh Frequency (trunked) audio system as the primary system while maintaining the existing Very High Frequency (low band) radio system as a redundant system. Hatfield & Dawson received the highest score of six respondents to RFP 925. Metropolitan entered into a three-year agreement with Hatfield & Dawson, effective January 2010. Management extended the agreement to December 2013, with a maximum amount payable of \$150,000 per contract year. As of November 2013, payments to Hatfield & Dawson totaled \$205,800.

In October 2010, Metropolitan issued RFQ 962 to provide as-needed environmental site assessment services that included performing field-testing, reviewing laboratory data analysis, and preparing written technical reports. Ninyo & Moore were among the top 3 of 27 respondents to RFQ 962. Metropolitan entered into a five-year agreement with Ninyo & Moore effective September 2011, with a maximum amount payable of \$245,000 per contract year. As of November 2013, payments to Ninyo & Moore totaled \$114,916.

In June 2011, Metropolitan entered into a three-year sole-source agreement with Process Applications to provide training, start-up, and process optimization services for the newly completed Robert B. Diemer Treatment (Diemer) Plant - Oxidation Retrofit Facility. Administrative Code Section 8140(2) states that a product or service may be exclusively requested either as a sole source or for competitive procurement if it is unique. The specialized team-training services that Process Applications provides to their clients fit this criterion. That is, they train key staff members on effective planning, communication, conflict resolution, and teamwork skills.

These skills are required to solve issues such as unscheduled Diemer plant outages, 24/7 operations, shift coverage, emergency operations, merging new and old Diemer plant operations, problem diagnosis, and trouble-shooting. In addition, Process Applications provides training to optimize Diemer plant operations and has successfully trained staff at the Joseph P. Jensen, Henry J. Mills, and Robert A. Skinner Treatment Plants. This agreement's maximum amount payable is \$200,000. As of November 2013, payments to Process Applications totaled \$109,899.

Lastly, in February 2012, Metropolitan issued RFQ 1011 to provide industrial hygiene and general safety services on an as-needed basis. These services help ensure compliance with the California Occupational Safety and Health Administration, Department of Safety and Health, Housing Urban Development, Environmental Protection Agency, and all other regulatory agency requirements and regulations. Industrial Hygiene received the highest score from 15 respondents. Metropolitan entered into a three-year agreement with Industrial Hygiene effective July 2012, with a maximum amount payable of \$200,000 per contract year. As of November 2013, payments to Industrial Hygiene totaled \$115,744.

Opinion

In our opinion, the accounting and administrative procedures over the consulting agreements with Hatfield & Dawson 109712, Ninyo & Moore 21218, Process Applications 121496, and Industrial Hygiene 130345 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 January 2010 through November 2013.

Comments and Recommendations

There were no material findings to report.

Quarterly Consulting Contracts Report Review

Scope and Purpose of Review

We reviewed the Quarterly Professional Services Agreements Report (Professional Report) published by the Professional Services Contracting Team for the first quarter of fiscal year 2013/14. The purpose of this review is to gain reasonable assurance that information included on the Professional Report is accurate, complete, timely, and in compliance with the Administrative Code.

Background

Administrative Code Section 2720(a)(2) requires 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 Authority under Sections 8121(c) and 8122(h), during the preceding calendar quarter. It further states that the Professional Report covering the last calendar quarter of the year may be combined with, and included in the annual report.

Finally, the Administrative Code also requires that the Professional Report indicate when a consultant is a former employee of Metropolitan. The Professional Report is prepared on a quarterly basis to comply with these Administrative Code requirements.

During the first quarter fiscal year 2013/14, the Professional Report disclosed that \$12.5 million was paid for consulting and professional services. It should be noted that totals reported under the General Counsel's authority excluded payments related to the San Diego County Water Authority litigation, which have been transferred to the Self-Insurance Retention Fund.

	General Manager	General Counsel
Contract Totals	\$12,300,000	\$200,000
Active Agreements	357	22
Agreements Terminated	40	0

Testing Procedures Performed

Our procedures included cursory review of the reasonableness of professional service expenditures, and consultants with multiple active agreements to determine whether an agreement was split into smaller contract amounts to override the established approval authority limits. We also evaluated whether statistics in the Professional Report were adequately supported. Finally, we assessed the timeliness of board reporting.

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. However, we noted that 4 of 6 board reports were issued 17 to 29 days, after the target issuance date.

Official Statement for the Water Revenue Refunding Bonds, 2009 Authorization, Series A2

The Audit Department has completed a review of the Official Statement for the Water Revenue Refunding Bonds, 2009 Authorization, Series A2. We performed this review to provide the issuer of the Bonds "comfort" that the Official Statement for the Bonds is complete, consistent with supporting financial records, and accurate in all material respects. We completed our review in accordance with agreed-upon procedures specified by the underwriter. We issued letters to the underwriter describing the agreed-upon review procedures performed, and the results obtained.



THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

Date: February 25, 2014

To: Gerald C. Riss, General Auditor

From: Octavia T. Tucker, Manager of Administrative Services

Subject: Response to review of the accounting and administrative controls over the Procurement Card Program (P-Card Program)

Thank you for the Audit Department's review of the P-Card program. We concur with your recommendations and have already taken immediate corrective actions to address the report findings. Importantly, the audit concluded that no financial losses occurred and no unusual items or personal purchases were identified within the scope of this audit. Equally important, your findings also provided valuable insight and recommendations for improving the accounting and administrative controls over the P-Card program.

Staff is fully committed to administering a program that is consistent with industry best practices, improves the timeliness and efficiency of purchasing specified items while maintaining the proper controls to reduce risk. Contracting Services Unit has begun updating the Operating Policy C-05, and reviewing existing procedures and manuals. Moreover, additional resources are being dedicated to ensure a consistent and robust administrative process that will track, analyze, and report on P-Card activity and take appropriate administrative action as necessary.

We will provide the cardholder and the approving manager with the appropriate training to support their role in oversight of the day-to-day P-Card activities, compliance with procedures and policies and the proper use of financial account coding of expenditures. It is anticipated that the majority of the action items indicated in our response will be implemented no later than March 31, 2014.

The attached matrix outlines our specific actions in response to the recommendations contained in your Report. This report was transmitted to me via your memorandum dated February 2, 2014. We appreciate your efforts and the valuable information contained in your report.

The Metropolitan Water District of Southern California
Summary of Findings and Recommendations for the
Report on Procurement Card Program dated January 16, 2014

Please feel free to contact me if you have any questions.



Octavia T. Tucker

OTT/cmt

Attachments (1)

cc:	J. Kightlinger	S.B. Bennion	A.A. Herrera
	M.L. Scully	F.M. Mares	D.M. Morioka
	D.R. Ghaly	J.C. Clairday	T.E. DeBacker
	D.C. Man	J.F. Green	A. Marquez
	G.F. Ivey	G.L. Johnson	A.C. Pellegrini
	G.M Breaux	D.N. Upadhyay	DM.T. Phan
	R.K. Patterson	R.L. Wolfe	F.O. Sanchez
	D. Zinke	C. Torres	

Findings and Recommendations	Response	Responsible Party	Completion Date
<p><u>REVIEW AND APPROVAL</u> We recommend that cardholders' management remind its staff of the importance of complying with established policies and procedures, specifically management approval for restricted purchases and proper coding of transactions to the correct general ledger accounts.</p>	<p>Concur. In collaboration with the various end user groups responsible for the coding of P-Card transactions, Contracting Services will implement a structured and formal process to notify the cardholder's and his/her management of improperly coded transactions.</p> <p>Concur. Contracting Services will develop and provide clear procedures for the approval of normally restricted items.</p>	<p>Torres/Poli</p> <p>Poli</p>	<p>March 31, 2014</p> <p>March 31, 2014</p>
<p>We recommend that Contracting Services Unit perform random reviews of P-Card transactions to ensure compliance. Lastly, we recommend that Program Management evaluate the need for cardholders where annual activity is low and consider cancelling the associated P-Cards.</p>	<p>Concur. Contracting Services will conduct regular compliance reviews and perform analysis and reporting of P-Card use and take appropriate actions regarding P-Cards with low annual activity. Random reviews will begin March 31, 2014.</p>	<p>Poli</p>	
<p><u>POLICY AND PROCEDURES</u> We recommend that Program Management remind personnel of the importance of complying with established card cancellation, renewal, or replacement procedures.</p>	<p>Concur. P-Card Administration staff will be trained on the importance of informing personnel of the need to comply with card cancellation, renewal, or replacement procedures and will develop a structured notification process that creates transparency for P-Card holder management. P-Card Administration staff will take appropriate action to ensure compliance.</p>	<p>Poli</p>	<p>March 31, 2014</p>

**The Metropolitan Water District of Southern California
Summary of Findings and Recommendations for the
Report on Procurement Card Program dated January 16, 2014**

Findings and Recommendations	Response	Responsible Party	Completion Date
We recommend that management update its P-Card Procedures Manual and Operating Policy C-05, "Metropolitan Credit Cards."	<p>Concur. Contracting Services has already begun updating P-Card operating policy.</p> <p>Concur. P-Card Administration staff will update manuals and procedures.</p>	Torres Poli	March 31, 2014 April 30, 2014
We recommend that management inform and train cardholders and approvers on current policies and procedures and conduct periodic reviews to ensure compliance.	Concur. P-Card administration staff will provide structured training to cardholders and approvers on current policies and procedures.	Poli	June 30, 2014
<p><u>COMPLIANCE WITH USE TAX REGULATIONS</u></p> <p>We recommend that the P-Card Administrator and Accounts Payable Manager resolve the noted discrepancies. In addition, we recommend that Management establish procedures to ensure that P-Card purchases outside the state are reviewed and that all applicable taxes are paid.</p>	Concur. Accounts payable staff will work with the P-Card Administrator to ensure that invoices are received on a timely basis for all items included on the "No Sales Tax" report.	Marquez/Poli	March 31, 2014
<p><u>PURCHASE DISCOUNTS</u></p> <p>We recommend that Contracting Services Unit Management emphasize the negotiation of purchase discounts whenever possible.</p>	Concur. Contracting Services Management will emphasize the importance of negotiating discounts on purchases.	Poli	June 30, 2014