



## **Audit Department Report for March 2015**

### **Summary**

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Six reports were issued during the month:

- **Water Information System Audit Report**
- **Desert Region Business Support Activities and Metropolitan Housing Audit Report**
- **Energy Management Hydroelectric Audit Report**
- **Macias Gini O'Connell, LLP Single Audit Report for Year Ended June 30, 2014**
- **Remarketing Statement for the Water Revenue Refunding Bonds, 2011 Authorization, Series A-2 and A-4**
- **Remarketing Statement for the Water Revenue Refunding Bonds, 2012 Authorization, Series B-1 and B-2**

### **Discussion Section**

This report highlights the significant activities of the Audit Department during March 2015. In addition to presenting background information and opinions expressed in the audit reports, a discussion of findings noted during the examination is also provided.

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## **Water Information System Audit Report**

### **Background**

The Audit Department has completed a review of the application controls over the Water Information System (WINS), as of December 31, 2014. Our review consisted of evaluating the internal controls over the data integrity, and reliability of WINS. Specifically, we evaluated the accuracy of the Automated Meter Reading (AMR) System data and certification data input into WINS. We also verified the accuracy and completeness of Water Rate Tables maintained in the AMR System. In addition, we evaluated the adequacy of access controls and examined the Data Backup and Recovery Procedures. Finally, we performed tests to ensure that program change controls complied with Metropolitan standards.

Metropolitan's principal revenue sources are water sales and exchange transactions. These include all revenues received by Metropolitan from charges for the sale and availability of water including Metropolitan's water rates, and Readiness-To-Serve and Capacity charges. These revenue flows primarily come from water sales to its 26 member agencies (Agencies). These Agencies can request water at various delivery points within Metropolitan's service areas and pay at rates based on the service level, as established by the Board.

Metropolitan established WINS as a core business application that processes water transactions, incentive payments, customer usage, revenue data, and storage account balances. The Controller Section of the Chief Financial Officer Group, together with the Water Resource Management Group, use the system to bill Agencies for water usage and apply conservation credits to each Agencies' monthly billing. Similarly, Agencies can use WINS to access their own usage data, certify conservation program participation, and update information such as billing addresses and contact information.

In July 2006, the Board appropriated \$3.5 million for an upgrade of WINS to a web-based Oracle application. The upgrade was completed in November 2008 and enabled the integration of new business rules, with minimal programming involvement that allowed for more system flexibility. The upgrade also automated data entry for Local Resources Program certifications, which reduced staff time and minimized data input errors. For fiscal year 2013/14, WINS processed approximately \$1.6 billion in water sales revenue.

### **Opinion**

In our opinion, the accounting and administrative procedures over WINS 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 from January 1, 2013 through December 31, 2014.

### **Comments and Recommendations**

#### **ACCESS CONTROLS**

Access controls should be established to protect against the unauthorized destruction, disclosure, or modification of computer stored data. This control is achieved by limiting access, based on an analysis of staff duties and responsibilities. In this regard, management should differentiate between the functions allowed ranging from an inquiry capability for most persons, to an override and correction capability for a few supervisory personnel. These restrictions are normally controlled by Logon identifications and passwords. Periodic reviews and updating of access authorities should be completed to account for staff transfers, new hires, and terminations. We noted during the review that one user account for a member agency employee remained on the active list, after their termination from said agency.

We recommend that Information Technology Section work with the Controller Office to establish a process to ensure that only active Agency employees can access WINS.

#### **SUCCESSION PLANNING**

Succession Planning is vital to an organization to achieve business continuity, in the face of employee turnover. This involves identifying key positions and formulating strategies, to ensure that one or more employee will not adversely affect processes and controls in the event of separation.

Metropolitan's Succession Plan should include identification and training of backup personnel for critical positions. We noted that responsibility for processing monthly invoices in WINS is delegated to one full-time employee. We could not find evidence that management has trained a backup employee for this critical position. Furthermore, we could not locate evidence of a Succession Plan in place for this job function.

We recommend management provide training for staff in the event of personnel shortages, and provide a Succession Plan for all critical positions.

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## **Desert Region Business Support Activities and Metropolitan Housing Audit Report**

### **Background**

The Audit Department has completed a review of the accounting and administrative controls over the Desert Region Business Support Activities (Desert Region Activities) and Metropolitan Housing (Housing), as of October 31, 2014. Our review consisted of evaluating the internal controls over administration of the Desert Region Activities and Housing. We tested compliance with the terms and conditions of service agreements, and evaluated the validity and propriety of invoice payments for assurance that amounts billed were properly calculated and adequately supported. We also reviewed compliance with Housing policies and procedures. Lastly, we verified that rents billed and collected from employees were accurate and complete.

The Conveyance and Distribution System (System) extends over 5,200 square miles, and serves approximately 19 million people. The System includes over 775 miles of pipelines and canals, 16 hydroelectric plants, 17 reservoirs, and hundreds of facilities and structures. The conveyance and distribution facilities are divided into three regions: Eastern, Western, and Desert. This audit encompassed a review of Desert Region Activities and Metropolitan housing.

The Desert Region operates with 129 full-time employees assigned to 13 teams, and 20 recurrent employees that are utilized on an on-call or as-needed basis. These 13 teams are Desert Region, Control Systems, Powerline Maintenance, Pump Maintenance, Gene/Intake, Iron, Eagle, Hinds, Facility Services, Business Support, Coatings, and Aqueduct Maintenance. During fiscal year 2013/14, operating costs totaled \$26.5 million for the Desert Region which included labor costs of \$18.8 million and water treatment chemical costs of \$3.5 million.

The Coatings Team (Coatings) of the Desert Region identifies and performs corrosion control, which includes asset protection and aesthetic maintenance coating throughout the Desert Region facilities. In addition, Coatings maintains, repairs, and refurbishes Metropolitan houses in the Desert Region. As of December 31, 2014, Housing located in the Desert Region consisted of 102 homes; 26 located in Riverside County and 76 located in San Bernardino County. Rents on Housing range from \$61 to \$109 per month, and calculated by multiplying home square footage by the predetermined rate codified in Metropolitan's Administrative Code.

### **Opinion**

In our opinion, the administrative procedures over the Desert Region Activities and Housing 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 from July 1, 2011 and October 31, 2014.

### **Comments and Recommendations**

#### **POLICIES AND PROCEDURES**

Policies and procedures should be periodically reviewed and updated to reflect organizational changes and operational needs. Policies are the set of principles, rules, and guidelines adopted by Metropolitan to meet long-term goals. Procedures assist management in training new employees, providing guidance for consistent performance of daily operations, and providing a source of reference for experienced personnel.

Date of Report: March 31, 2015

Metropolitan's Administrative Code Section 6563, Metropolitan Housing (Section 6563); Operating Policy J10, Conditions of Occupancy for Metropolitan District Housing; AFSCME Memoranda of Understanding Section 4.10, Metropolitan Housing (MOU); and Desert Region Desk Procedures Manual: Housing Section establishes the policies and procedures for administration over Housing. During our review, we noted:

1. Inconsistencies in the stipulated rental rates between Section 6563 and the MOU. For example, Section 6563 indicates a rental rate of 6.28 cents per square foot of living space in Gene Village. However, the MOU indicates a rental rate of 6.50 cents per square foot of living space in Gene Village.
2. Section 6563 procedures were incomplete. Specifically, we noted a lack of written guidelines for initiating, reviewing, approving and processing maintenance or repairs of Housing, and a lack of eviction procedures.

We recommend management revise Section 6563 to ensure consistency of rate per square foot of living space with the MOU. We also recommend that Water System Operations Group management establish a target date to address deficiencies in the Metropolitan Housing Desk Procedures Manual and periodically update procedures, as needed.

#### COMPLIANCE WITH TERMS AND CONDITIONS OF PURCHASING, SERVICES, AND RENTAL AGREEMENTS

Compliance with contractual requirements is necessary to ensure accurate accounting records, proper supporting details, and adequate controls over administration of the agreements. Compliance with contractual terms and conditions also ensures parties fully discharge their duties and obligations, and exercise their rights associated with the agreements.

For rental agreements between Metropolitan and its employees renting Metropolitan-owned residences in the Desert Region, monthly rent is based on location and square footage of the property living spaces and paid biweekly through employee Payroll deductions. Our review of compliance with vendor service agreements and employee rental agreements revealed:

1. Service invoices for 10 of 40 (25 percent) tested were paid 35 to 78 days after receipt of invoice instead of 30 days after receipt, as required by agreements. Further review revealed that invoices were paid late due to lack of communication between buyers, requesters, receivers, and Accounts Payable.
2. Rental agreements for one of 30 (3 percent) tested specified the monthly rent as \$84 per month. However, Payroll deduction was \$82 per month from June 2011 through June 2014, resulting in a \$72 underpayment for the period.

We recommend management request the additional rent payment from underpaid tenant. In addition, we recommend management remind its staff of the importance of complying with agreement terms and conditions, and conduct periodic reviews to ensure compliance.

## MANAGEMENT REPORTS - HOUSING COSTS

Management reports are designed to combine information into a meaningful form in order to assess the efficiency of operations, identify budget variances and cost trends, and develop effective strategic plans. These reports can be informative (e.g., measurement of volume) or analytical (e.g., percent change in expenditures). For Housing, management reports should be prepared detailing the fully burdened labor costs associated with repairs, maintenance, and upkeep of the permanent Housing facilities. This information is vital for long-range fiscal planning, facility cost budgeting, and for comparison of alternate housing strategies.

During our review, we noted that management reports provided details on direct labor costs and outside service contracts for repairs and maintenance on Metropolitan houses. However, the direct labor cost totals did not reflect fully burdened labor rates. That is, additive and overhead costs were not utilized in preparation of these reports. Additive costs includes employee fringe benefits; whereas, overhead cost includes administrative costs. These rates change annually ranging from 70 percent to 105 percent.

We recommend management consider applying fully burdened labor rates to Metropolitan Housing Cost Reports.

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## Energy Management Hydroelectric Audit Report

### **Background**

The Audit Department has completed a review of the accounting and administrative controls over Energy Management - Hydroelectric Contracts, as of December 2014. Our review consisted of evaluating the accounting and administrative controls over hydroelectric power operations. We reviewed the agreement administration of hydroelectric contracts with energy buyers, recording and reporting practices, and tested compliance with terms and condition of the contracts. In addition, we evaluated the validity and propriety of Metropolitan's energy billings and their subsequent collection for assurance that amounts billed were properly calculated, adequately supported, and promptly collected. Lastly, we reviewed the inspection and maintenance of power meters installed at the hydroelectric power plants.

Metropolitan Water District Act (Act), Section 139, allows Metropolitan to acquire, construct, operate, and maintain any and all works, facilities, improvements, and property to provide, generate, and deliver electric power necessary to carry out the objects or purposes of Metropolitan. The Act also allows Metropolitan to sell and deliver electric power to federal, state, public agencies, private corporations, or persons engaged in the sale of electric power at retail or use all or any part of such electric power directly or by exchange.

These powers expressly grant Metropolitan the means to obtain the energy needed to complete its mission. Starting in the 1970s, Metropolitan began an extended Capital Improvement Program to construct 14 hydroelectric plants. Moreover, two additional hydroelectric plants were constructed in 1994 and 2001. Each hydroelectric plant capacity ranges between one and 30 megawatts, with total installed capacity of 131 megawatts. It should be noted that actual power generation at these hydroelectric plants is dependent upon water deliveries through the water distribution system.

In conjunction with the operation of these power plants, Metropolitan entered into energy sale agreements with the California Department of Water Resources in 1978, Pacific Gas and Electric Company in 1994, Southern California Edison in 1982 (amended 2003, renewed 2008), Automated Power Exchange in 2004, Los Angeles Department of Water and Power in 2008, and the Southern California Public Power Authority in 2008. These agreements required that Metropolitan sell the electric energy produced by all 16 power plants to respective energy buyers. These agreements are effective for 15 to 20 years, or set to expire 10 years after a termination notice.

### **Opinion**

In our opinion, the accounting and administrative procedures over Energy Management - Hydroelectric 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 from October 2011 through December 2014.

### **Comments and Recommendations**

#### REVENUE RECORDING

Revenue is recognized by an entity when the earning process is completed or virtually completed, and an exchange between two or more parties has taken place. That is, revenue arises when goods or services are exchanged for value, or when disposing of resources such as equipment or investments. For hydroelectric energy sales, Metropolitan recognizes the revenue from the transaction when energy is supplied to the customer, the amount is known, and Metropolitan issues an invoice for energy provided. Timely and proper revenue recordation should be made to ensure that financial statements reflect economic activities of the entity. Our review of hydroelectric billings for fiscal year 2013/14 revealed that four months of hydroelectric billings were recorded as an offset to Utility Charges Expense Account 44100, rather than to Power Recoveries Revenue Account 31300.

We recommend management remind personnel of the importance of accurately recording transactions.

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## **Macias Gini O'Connell, LLP Single Audit Report for Year Ended June 30, 2014**

The Federal Single Audit Act of 1984, as amended by the Single Audit Act Amendments of 1996, requires state or local government units that expend \$500,000 or more of federal financial assistance in any one year to have an audit conducted for that year. In the event a Single Audit report is required of Metropolitan for the year, the cost of such an audit is included as part of the required audit services provided by Macias Gini & O'Connell, LLP (MGO) under its agreement with Metropolitan. Due to the magnitude of federal source monies expended during the fiscal year ending June 30, 2014, Metropolitan was required to have a Single Audit performed. MGO performed the necessary auditing procedures, and issued the following required audit reports:

1. Report of Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statement Performed in Accordance with Government Auditing Standards.
2. Report on Compliance for each major program; Report on Internal Control over Compliance; and Report on Schedule of Expenditures of Federal Awards Required by OMB Circular A-133, Audits of States, Local Governments, and Nonprofit Organizations.

### **Remarketing Statement for the Water Revenue Refunding Bonds, 2011, Series A-2 and A-4**

The Audit Department has completed a review of the Remarketing Statement for the Water Revenue Refunding Bonds (Bonds), 2011 Authorization, Series A-2 and A4. This review was undertaken to provide the remarketers of the Bonds “Comfort” that the Remarketing Statement for the Bonds is complete, consistent with supporting financial records, and accurate in all material respects. The review was completed and no exceptions were noted. We issued letters describing the agreed-upon review procedures performed, and the results obtained to the remarketers of the Bonds.

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### **Remarketing Statement for the Water Revenue Refunding Bonds, 2012, Series B-1 and B-2**

The Audit Department has completed a review of the Remarketing Statement for the Water Revenue Refunding Bonds (Bonds), 2012 Authorization, Series B-1 and B-2. This review was undertaken to provide the remarketers of the Bonds “Comfort” that the Remarketing Statement for the Bonds is complete, consistent with supporting financial records, and accurate in all material respects. The review was completed and no exceptions were noted. We issued letters describing the agreed-upon review procedures performed, and the results obtained to the remarketers of the Bonds.

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