



Internal Audit Report for December 2015

Summary

Three reports were issued during the month:

- **Robert B. Diemer Plant – Facility Maintenance Program Audit Report**
- **Budget and Variance Reporting Audit Report**
- **Official Statement for the Water Revenue Refunding Bonds, 2015 Authorization, Series A**

Discussion Section

This report highlights the significant activities of the Internal Audit Department during December 2015. 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.

Robert B. Diemer Plant – Facility Maintenance Program Audit Report

Background

The Audit Department has completed a review of the accounting and administrative controls over the Robert B. Diemer Treatment (Diemer) plant - Facility Maintenance Program, as of June 30, 2015. Our review consisted of evaluating recordation of preventive, corrective, and emergency maintenance activities in the MAXIMO Maintenance Management System.

In addition, we evaluated the validity and propriety of invoice payments related to maintenance expenses such as landscape, janitorial, equipment, parts, and material purchases for assurance that amounts billed were properly calculated and adequately supported. Further, we evaluated the propriety and accuracy of reported maintenance costs and reviewed work order documentation for completeness. Finally, we examined reports on physical cycle counts for Class A Fixed (A) Assets and Class B Fixed (B) Assets.

Diemer plant is located in the City of Yorba Linda, and was placed into service in 1963 to treat Colorado River water. Over the years, Diemer plant was retrofitted as a blend plant such that Colorado River and State Water Project deliveries are received and treated at the plant. Diemer plant has a total treated water capacity of 520 million gallons per day and supplies water to the City of Anaheim, City of Fullerton, City of Long Beach, City of Santa Ana, Central Basin Municipal Water District, West Basin Municipal Water District, and the Municipal Water District of Orange County.

Although Diemer plant is equipped with many automated systems to aid in the treatment and delivery of water, plant operators must monitor and adjust systems to ensure effective and efficient plant operations.

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Diemer plant's workforce consists of 53 full-time employees assigned to teams from Business Support, Control Systems Operations, Electrical Maintenance, Mechanical Maintenance, and Treatment Operations.

Opinion

In our opinion, the accounting and administrative procedures over Diemer plant - Facility Maintenance 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 controls from July 2012 through June 2015.

Comments and Recommendations

COMPLIANCE WITH REGULATORY REQUIREMENTS

Compliance with established procedures and regulatory requirements is necessary to provide accurate records, proper supporting details, and adequate controls over the preventive maintenance program. These maintenance records should include evidence that required Regulatory Preventative Maintenance (RPM) Work Orders were completed on a timely basis. During our review of Monthly Maintenance Reports, we noted the completion rate for RPM Work Orders for 12 of the 20 months tested did not meet standards. The reported completion rate was between 88 to 98 percent, rather than the established standard of 99 percent.

We recommend management remind personnel of compliance importance with established procedures and regulatory requirements, and conduct periodic checks to ensure compliance.

COMPUTER SOFTWARE LIFE CYCLE

Computer software life cycle includes product development, general availability, supported lifetime, and unsupported end-of-life obsolescence. Software use should track these phases such that new software should not be installed until testing is completed, and general release versions are available. Software should be uninstalled and abandoned when product support is stopped and the developer no longer provides fixes, updates, or technical assistance.

During our review, we examined the top 20 assets with the highest number of Corrective Maintenance (CM) Work Orders. Fourteen of 20 CM Work Orders (70 percent) were to repair the Remote Terminal Units (RTUs) used to input data to the Supervisory Control and Data Acquisition System to support monitoring, control, and automation of water treatment and distribution functions. While there were several root causes for RTU failures, we noted these units were installed on a Windows 2000 Graphical Operating System. It should be noted that Microsoft has not supported the Windows 2000 Platform since July 2010.

We recommend that Water System Operations management consider upgrading the RTU operating system.

CYCLE COUNTS

Physical cycle counts provide an ongoing measure of inventory accuracy, procedure execution, and help identify the root causes of inventory errors. These Physical cycle counts are used to adjust asset ledgers to accurately reflect inventory balances and account for disposed or missing equipment, duplicate entries, or errors. The Operating and Expensed Equipment Manual, Chapter 5 – Cycle Count, requires all A Assets such as audio visual equipment, communication equipment, and computer hardware and peripherals be counted every 12 months. In addition, the Manual requires that all B Assets such as construction equipment, lab equipment, pumps, vehicles, and portable buildings be counted every 18 months.

Our review of the 2013 and 2014 cycle count documentation revealed that A Assets work was not completed until September 2015. In addition, we could not locate evidence that cycle counts for B Assets were performed in 2013 and 2014. It should be noted that a cycle count over B Assets is currently in progress.

We recommend management remind personnel of the importance of compliance with established procedures, and conduct periodic tests to ensure compliance.

Budget and Variance Reporting Audit Report

Background

The Audit Department has completed a review of the accounting and administrative controls over the Metropolitan budget process, as of June 30, 2015. Our review consisted of evaluating the administration of the Operations and Maintenance (O&M), and Operating Equipment Budget processes. We also evaluated Metropolitan management's efforts to track Budget vs. Cost Reporting trends, and their compliance with Budget Variance explanation requirements. Lastly, we assessed the security and access controls over the Integrated Budget Management System (IBMS).

Metropolitan's Administrative Code Section 5107, requires management to prepare a biennial budget under the direction of the General Manager. It requires management to submit the biennial budget to the Board no later than the regular June Board meeting, preceding the first fiscal year of the biennium to which the budget applies. The purpose of the annual budget is to identify adequate financial resources to support Metropolitan's mission, and to provide a basis for accountability in fiscal management.

The budget process includes preparation of the Routine O&M, Major O&M, Operating Equipment, General Metropolitan Requirements, and Capital Investment Plan (CIP) budgets. The Routine O&M budget identifies planned expenditures for the ongoing operation, and maintenance of Metropolitan functions (mainly recurrent) for the budgeted fiscal years. The Major O&M budget identifies significant or often nonrecurring planned expenditures involving a significant or nonroutine level of effort, or for work that is considered sufficiently significant to call out and track independently of Routine O&M.

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The Operating Equipment budget is comprised of various groups operating equipment needs by each fiscal year of the biennium. Metropolitan defines operating equipment as any equipment, tool, furniture, vehicle, or other item which costs more than \$5,000 and has a useful life of at least five years; three years for computers and four years for vehicles. Moreover, these assets are purchased through the General Fund 1001 and included in the O&M Departmental Budget total. The O&M budgets, including operating equipment for fiscal years 2013/14 and 2014/15 were \$390.5 million and \$413.7 million.

The final component of the budgeting process is the Capital Investment Plan. This is comprised of expenditure estimates for all capital projects approved or anticipated to be undertaken over, as long as a 20-year period. Although part of the overall budget process, approval of the budget does not necessarily appropriate funding for capital work. Appropriation of funds is by separate board action on a project-by-project basis, and obtained continuously throughout the year as dictated by individual project schedules. Our review did not include CIP activity.

Opinion

In our opinion, the accounting and administrative procedures over Metropolitan's budget process 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 2013 through June 2015.

Comments and Recommendations

POLICIES AND PROCEDURES

Operational policies and procedures are established to provide a framework for achieving organization goals and objectives. Procedures provide guidelines for consistent performance of daily operations, assist in the training of new employees, and provide a source of reference for experienced personnel. Budget procedures should provide guidelines for preparation, monitoring, reporting of budget trends, and completion of variance analysis. Our review of IBMS O&M Budget vs. Actual costs revealed inconsistencies in the completion of variance analysis.

We recommend the Budget and Financial Planning Section establishes guidelines for budget variance explanations, and encourages users to follow the guidelines established.

ACCESS CONTROLS

Access controls 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 functions allowed ranging from an inquiry capability for most persons, to an override and correction capability for a few supervisory personnel. Periodic review and updating of access authorities should be completed to account for staff transfers, new hires, and separations. Our review revealed that six former employees still had access rights to IBMS.

We recommend management correct the noted discrepancies, and conduct periodic reviews of access controls to prevent unauthorized access to IBMS.

REVIEW AND APPROVAL

Review and approval controls are designed to verify the accuracy of documentation, provide assurance as to the propriety of transactions, and ensure that follow-up procedures exist for exception processing. For Operating Equipment purchases, authorized personnel review invoiced items for propriety and accuracy. We traced, and agreed 30 Operating Equipment purchases from the IBMS Budget to Cost Reports, and noted:

1. Ten items were coded to wrong accounts. In addition, 14 items appeared in an Exception Report but not explained or cleared by staff.
2. Management approval for two of 12 Out-of-Budget Requests could not be located.
3. The fiscal year 2013/14 restated budget amount reported for Operating Equipment in the Biennial Budget Summary Report for fiscal years 2014/15 and 2015/16 (O&M), could not be traced to IBMS.

We recommend that Metropolitan's Budget and Financial Planning Group remind budget coordinators of the importance of complying with IBMS policies and procedures. We also recommend the Budget and Planning Group perform periodic reviews to ensure compliance.

Official Statement for the Water Revenue Refunding Bonds, 2015 Authorization, Series A

The Audit Department has completed a review of the Official Statement for the Water Revenue Refunding Bonds, 2015 Authorization, Series A. 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 underwriters. We found such information to be correct in all material respects. We issued letters to the underwriters describing the agreed-upon review procedures performed, and results obtained.
