



## Internal Audit Report for September 2016

### **Summary**

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Three reports were issued during the month:

- **Accounts Payable Imaging Module**
- **Quarterly Board Reports Review**
- **Official Statement for the Water Revenue Refunding Bonds, 2016 Authorization, Series B1 and B2**

### **Discussion Section**

This report highlights the significant activities of the Internal Audit Department during September 2016. In addition to presenting background information and the opinion expressed in the audit report, a discussion of findings noted during the examination is also provided.

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## **Accounts Payable Imaging Module**

### **Background**

The Audit Department has completed a review of the administrative and application controls over the Accounts Payable (AP) Imaging Module (Imaging), as of June 30, 2016. Our review consisted of evaluating the adequacy of internal controls over AP Imaging. We evaluated the processes related to invoice scanning, image review and correction, and system deployment. In addition, we tested security access settings and Backup and Recovery preparedness.

Historically, the Accounts Payable staff of the Controller's Section process over 4,000 invoices per month. These transactions were largely paper driven which introduced inefficiencies that increased costs, included shipping paper documents from one office to another, physically processing the documents such as data entry and review, storing documents in file cabinets and warehouses, and finding filed documents. Moreover, manual processing increased the incidence of processing errors, and could result in compliance issues with retention policies.

In October 2013, the Board appropriated \$1.18 million to replace the existing manual process with AP Imaging. This document capture and imaging system expedited invoice processing by eliminating manual data entry and paper invoice archives. The document capture feature is used with a document scanner to scan paper invoices, import faxed or emailed invoices, and converts them to images. Once scanned or imported, the index module is used to apply metadata to the images.

To help reduce the amount of manual indexing (data entry), the document capture includes key-from-image automation features including Optical Character Recognition (OCR), pick lists, and database lookups. The result is an end-to-end, capture to archive invoice processing system. During fiscal year 2015/16, the Controller's Section processed over 50,000 invoices totaling \$44.7 million.

### **Opinion**

In our opinion, the administrative and application controls over AP Imaging 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 November 1, 2014 and June 30, 2016.

### **Comments and Recommendations**

#### **APPLICATION CONTROLS**

Application controls ensure the completeness, accuracy, and validity of computer stored data. This control is achieved through the design of input controls, authentication checks, and integrity tests. For the AP Imaging process, the controls may include reviewing the accuracy of the invoice image scanning process, verifying the correctness of data captured through OCR, validating input against the associated purchase orders, and monitoring for delays in processing invoices. Our review revealed:

1. Two hundred fifty-five of 2,075 selected invoices were scanned into AP Imaging over 30 days, after the invoice date; 47 of 255 were scanned over 90 days, after the invoice date; and nine were scanned over one year, after the invoice date.
2. One of 99 selected invoices did not reference a Purchase Order, as payment support.

We recommend management establish controls to ensure invoices are scanned into AP Imaging, on a timely basis. We also recommend that management ensure all invoiced items are referenced to the supporting Purchase Order.

#### **DISASTER RECOVERY**

Disaster Recovery consists of policies and procedures that ensure the availability of IT applications and infrastructure required by critical business functions through Recovery Plan development, training, and exercises. Central to this process is the preparation of a Business Impact Analysis (BIA), the objective of which is to identify the mission's essential functions and application systems most crucial to ongoing business operations.

As the front end of the critical Oracle Accounts Payable System, AP Imaging should be included in the BIA to ensure the invoice payment process is recoverable following a disaster. In addition, manual procedures for the AP Imaging process should be documented and tested, to ensure the process can temporarily be performed manually in the event of system disruption. Finally, periodic Disaster Recovery exercises should be conducted to ensure critical applications and data files can be recovered post-system implementation, and especially considering periodic maintenance and enhancements. During the review we noted:

1. The BIA for AP Imaging could not be located. It should be noted that AP Imaging was deployed, after the current BIA revision in August 2014.
2. Evidence of manual procedures testing, along with a live exercise in the event of system disruptions could not be located.
3. Evidence of Disaster Recovery exercises to recover AP Imaging, could not be located.

We recommend that the Office of the Chief Financial Officer update BIA to consider the criticality of AP Imaging. We also recommend that manual work around procedures and disaster test scripts be developed and tested.

#### ACCOUNTS PAYABLE HANDBOOK

Operating policies and procedures should be established and documented to provide a framework for achieving Metropolitan's goals and objectives. Procedures provide management with guidelines for consistent performance of daily operations, assist in the training of new employees, and provide a source of reference for experienced personnel.

For AP Imaging, policies and procedures should document the AP Imaging work flow, and record retention requirements and archiving process in the event of data loss or disaster. During our review, we noted that the AP Handbook was not updated to include AP Imaging procedures.

We recommend that the AP Handbook be updated to include policies and procedures for AP Imaging processing.

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## Quarterly Board Reports Review

### **Background**

We reviewed the Report of Professional Services Agreements (Professional Services Report) and the Report of Contracts for Equipment, Materials, Supplies, and Routine Services of \$250,000 or Above Contracts (Contracts Report) for the Third Quarter of fiscal year 2015/16, published by the Business Technology Group, Administrative Services. The purpose of this review is to gain reasonable assurance that information included in these reports is accurate, complete, timely, and in compliance with the Metropolitan Water District Administrative Code.

#### PROFESSIONAL SERVICES AGREEMENTS REPORT

### **Background**

Administrative Code Section 2720(e)(2) requires that the General Manager report to the Organization, Personnel and Technology 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.

The Administrative Code also requires the Professional Services Report indicate when a consultant is a former Metropolitan employee. Administrative Code Sections 2721-2723 require the General Counsel, General Auditor, and Ethics Officer report quarterly to their respective committee concerning any expert or professional service agreements executed pursuant to their authority under the Administrative Code. The Professional Services Report is prepared on a quarterly and annual basis to comply with these Administrative Code requirements and identify those contracts administered by the General Manager, General Counsel, General Auditor, and Ethics Officer.

During the quarter ending March 2016, the Professional Services Report disclosed that \$55.4 million was paid for consulting and professional services. We compared the amounts expended on professional services during this quarter against the prior fiscal year third quarter, and noted an increase of \$2.8 million.

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 is accounted for under the Self-Insurance Retention Fund. For fiscal year 2015/16, 58 of 388 agreements were sole-source agreements totaling \$2.6 million. This is one percent of total fiscal year-to-date expenditures totaling \$190.7 million in fiscal year 2015/16. We noted that 71 of 388 agreements were small purchases of less than \$24,999, totaling \$155,741 of total fiscal year-to-date expenditures in fiscal year 2015/16. See table below for details:

FY 2015/16	General Manager	General Counsel	General Auditor	Ethics Officer
Contract Expenditures	\$190,427,988	\$256,348	\$295,161	\$7,600
Active Agreements	349	91	2	4
Agreements Terminated	31	0	2	0

**Testing Procedures Performed**

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

**Testing results**

Our review did not reveal any agreements that appeared to be unreasonable, or split to override established approval limits. In addition, our review did not reveal any material differences between reported amounts and supporting documentation. Finally, we noted the Professional Services Report was issued to the Board on June 14, 2016.

**CONTRACTS FOR EQUIPMENT, MATERIALS, SUPPLIES, AND ROUTINE SERVICES OF \$250,000 OR ABOVE REPORT**

**Background**

Administrative Code Section 2720(e)(2) requires that the General Manager report to the Organization, Personnel and Technology Committee on the execution of any contract authorized under Section 8122(g) – Contracts for Equipment, Materials, Supplies and Routine Services. This Administrative Code section states that the General Manager may execute contracts for the purchase of materials, supplies, and other consumable items such as fuels and water treatment chemicals generally identified in the budget regardless of dollar value, provided that sufficient funds are available within the adopted budget for such purchases.

The Contracts Report is prepared on a quarterly basis to report on contracts that comply with these Administrative Code requirements. During the quarter ending March 31, 2016, the Contracts Report disclosed 14 contracts fitting these criteria. We noted the total maximum amount payable for these contracts was \$25.3 million. Ten of these 14 contracts were awarded as a result of competitive bidding, whereas the remaining four were sourced through cooperative agreements under Administrative Code Section 8140 – Competitive Procurement.

**Testing Procedures Performed**

Our procedures included a cursory review of the reasonableness of expenditures. We also verified that all contracts of \$250,000 or more for specified items were included in the Contracts Report, and adequately supported. Finally, we assessed the timeliness of board reporting.

**Testing results**

Our review did not reveal any discrepancies between contracts and amounts shown in the Contracts Report, and supporting documentation. We also noted that the policies and procedures for competitive bidding, cooperative agreements, and awarding sole-source agreements are in place. Finally, we noted the Contracts Report was issued to the Board on June 14, 2016.

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**Official Statement for the Water Revenue Refunding Bonds, 2016  
Authorization, Series B1 and B2**

The Audit Department has completed a review of the Official Statement for the Water Revenue Refunding Bonds, 2016 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.

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