



## **Internal Audit Report for February 2017**

### **Summary**

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Three reports were issued during the month:

- 1. Stores Inventory**
- 2. Official Statement for the Water Revenue Bonds, 2017 Authorization Series A**
- 3. Member Agency Administered Turf Removal Program**

### **Discussion Section**

This report highlights the significant activities of the Internal Audit Department during February 2017. 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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## **Stores Inventory**

### **Background**

The Administrative Services Section in the Business Technology Group is responsible for managing stores inventory in eight warehouses. These facilities stock common supplies utilized for maintenance, repair, and construction activities and include items such as pipe fittings, tools, filters, flashlights and work boots. Metropolitan utilizes an inventory management system with barcode readers to track inventory from the time it is received until it is disbursed to personnel. The system also tracks inventory usage, triggers purchase actions, and is used to conduct cycle count testing.

Inventory control activities are guided by Operating Policy F-08, "Stores Inventory Verification," and by the "Warehouse Inventory Cycle Count Procedures," established by the Administrative Services Section. Cycle count procedures are performed by Administrative Services Section personnel based on criteria issued by the Controller's Section of the Chief Financial Officer.

Cycle counts require a selection of inventory items in a location to be counted on a specific day. Over the course of each calendar year, all items valued from \$3.01 to \$49.99 are counted once, all items valued at \$50.00 or more are counted twice. Unlike a full physical inventory, cycle counts are less disruptive to daily operations and provide a continuous measure of inventory accuracy and procedure execution.

In addition, the Chief Financial Office staff performs surprise cycle counts at two warehouses each quarter and reconciles the results to the Oracle financial system. The balance of stores inventory as

of October 1, 2016 was \$9.3 MM. The total excludes chemical inventory, which is controlled separately by Water Systems Operations. From July 1, 2014 to October 1, 2016, \$6.1 MM of stores inventory was issued from the warehouses.

### **Opinion**

In our opinion, the accounting and administrative procedures over Stores Inventory 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 of July 1, 2014 to October 1, 2016.

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### **Official Statement for the Water Revenue Bonds, 2017 Authorization Series A**

The Audit Department has completed a review of the Official Statement for the Water Revenue Bonds, 2017 Authorization Series A. We performed this review as required by the Bond Purchase Contract between Metropolitan and the Underwriter for the Bonds. We performed verification procedures on selected tables, statistics, and other financial data contained in the Official Statement. These procedures consisted of comparing financial information contained in the Official Statement with Metropolitan's general accounting records. Our work disclosed no discrepancies. We issued letters to the Underwriter describing the specific procedures performed and results obtained.

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### **Member Agency Administered Turf Removal Program**

We have completed a limited review of the administrative controls over the Member Agency Administered (MAA) Turf Removal Program as of September 30, 2016. The objective of this review was to evaluate compliance with Metropolitan's Guidelines for Turf Removal Incentives and the member agencies' inspection and verification procedures. In addition, we reviewed the accuracy and timeliness of board/management reports.

Our review was limited in scope to the objectives described above and did not include an assessment of internal controls nor did it review compliance with these controls for the nine participating member agencies. Accordingly, we do not express an opinion on the internal control structure over the MAA Turf Removal Program.

Our tests covered the period July 1, 2014 through November 30, 2015. During this period, member agencies processed 7,684 rebate applications and made \$47 million in incentive payments for 22.8 million square feet of turf removed. Of the \$47 million total incentive payments, \$42.7 million was funded by Metropolitan and \$4.3 million was funded by the member and/or their retail agencies. The following table lists the nine member agencies participating in these programs.

Member Agency	Metropolitan Incentives	Member & Retail Agencies Incentives	Total Incentives	Square Feet of Turf Removed			Application Count
				Commercial	Residential	Total	
Municipal Water District of Orange County	\$ 18,262,857	\$ 1,765,277	\$ 20,028,135	6,428,746	3,237,940	9,666,686	3,727
Western Municipal Water District	\$ 8,658,541	\$ -	\$ 8,658,541	2,051,490	2,439,553	4,491,043	1,137
Los Angeles Department of Water and Power *	\$ 8,835,285	\$ 1,113,500	\$ 9,948,784	5,105,149	-	5,105,149	136
Three Valleys Municipal Water District	\$ 2,083,956	\$ -	\$ 2,083,956	-	1,062,509	1,062,509	556
Las Virgeners Municipal Water District	\$ 2,291,321	\$ -	\$ 2,291,321	-	1,154,164	1,154,164	727
City of Long Beach	\$ 1,633,136	\$ 1,198,628	\$ 2,831,764	-	816,568	816,568	1,010
Foothill Municipal Water District **	\$ 461,550	\$ -	\$ 461,550	-	230,775	230,775	146
Inland Empire Utilities Water Agency **	\$ 277,422	\$ 144,802	\$ 422,224	-	138,711	138,711	156
City of Santa Monica **	\$ 186,002	\$ 85,442	\$ 271,444	-	93,001	93,001	89
<b>Total</b>	<b>\$ 42,690,070</b>	<b>\$ 4,307,649</b>	<b>\$ 46,997,719</b>	<b>13,585,385</b>	<b>9,173,221</b>	<b>22,758,606</b>	<b>7,684</b>

\* From 7/1/14 through 9/30/15 as member Agency in in process of compiling data.

\*\* From 7/1/14 through 6/30/15 as agency is in process of compiling/collecting data from its retail agencies.

## Testing Procedures Performed

We judgmentally selected 52 incentive payments made between July 1, 2014 and November 15, 2015 for testing. These payments totaled \$12.6 million and included 24 commercial applications totaling \$12.3 million (6.5 million square feet of turf removed) and 28 residential applications totaling \$341,000 (162 thousand square feet of turf removed). Of these selections, we performed GIS mapping on 13 applications (5.4 million square feet), wheeled measurements for 13 applications (1 million square feet), and performed drive-by inspections on 26 applications (156,344 square feet). In addition, we tested member agencies' compliance with their inspection and verification procedures and completeness of their rebate documentation. Lastly, we verified the accuracy of incentive payments reported to the Board by the WRM Water Efficiency Team and compared those payments to the member agencies' records.

## Testing results

### A. Policies and Procedures

1. Five of nine member agencies have informal verification and inspection procedures. These member agencies are Foothill, Santa Monica, Three Valleys, Long Beach, and Los Angeles Department of Water and Power.
2. Five of nine member agencies lack detailed instructions for aerial and manual (wheeled) site measurements. These member agencies are Foothill, Santa Monica, Three Valleys, Las Virgenes, and Western Municipal Water District.
3. One of nine member agencies (Three Valleys) did not identify the application/source used to perform aerial site measurements.

We recommend that WRM management modify the Guidelines for Turf Removal Incentives to address the noted deficiencies and provide the updated operating procedures to the member agencies participating in the MAA Turf Removal Program. We also recommend that the WRM Water Efficiency Team perform sample testing of rebate payments processed after the update to ensure compliance with program standards.

## B. Drive by, On-site Inspection and Geospatial Analysis

1. Manual (wheeled) measurements for 6 of 42 applications were 55,425 square feet less than the amount rebated. This resulted in a potential combined overpayment of \$103,540. Reimbursement of \$99,888 (96.5%) has already been made to Metropolitan. Details are shown below:

Item	Member Agency	Project Description	Reservation No.	City	Square Feet Rebated	Square Feet Measured	Difference (sf)	Potential Overpayment (\$/sf)
1	MWDOC	Commercial	TR5W-IRWD 2445	Irvine	224,935	202,440	22,495	\$ 44,990 *
2	MWDOC	Commercial	TR5W-IRWD 2292	Irvine	114,114	89,747	24,367	\$ 41,424 *
3	MWDOC	Commercial	TR5W-IRWD 2526	Irvine	61,689	54,952	6,737	\$ 13,474 *
4	Foothill	Residential	LC-HK 2424**	La Crescenta	6,400	5,189	1,211	\$ 2,422
5	Western MWD	Commercial	CR-7157**	Riverside	187,000	186,621	379	\$ 758
6	Three Valleys	Residential	140904-224	La Verne	9,986	9,750	236	\$ 472
				<b>Total</b>	<b>604,124</b>	<b>548,699</b>	<b>55,425</b>	<b>\$ 103,540</b>
* As of September 30, 2016, Municipal Water District of Orange County (MWDOC) had fully reimbursed Metropolitan (total \$99,888).								
** Reservation number not provided by the member agency. Number shown represents General Auditor Office's audit observation identifier.								

2. Lack of specific instructions to account for swap parcels. Moreover, reconciliations between total areas applied and total areas swapped were not being performed in the projects to verify the veracity of eligible parcels for rebate under the Guidelines for Turf Removal Incentives (e.g., LADWP applicant LVC5800).
3. Los Angeles Department of Water and Power's inspection acceptable error rates of 20% for residential and 10% for commercial/public agency were applied without consideration for the dollar amount of the application.
4. We were unable to inspect one residential property located in Santa Monica because the owner was not responsive to our repeated requests to gain access for an onsite inspection.

We recommend that WRM management address the noted discrepancies.

## C. Review and Reconciliation of Rebate Payments

1. Total rebate payments of \$54 million through June 30, 2016 that was included in the WRM Conservation Update Report to the Board was understated by \$5.8 million as two member agency payments were missed that month but were accounted for moving forward. This amount represents total rebate payments made by the member agencies for the same period. We also noted that the reported rebate amounts were not reconciled periodically to the member agencies' project-to-date rebate payments.
2. Procedures were not performed by the member agencies or by WRM staff to check for potential duplicate payments. Our tests did not reveal any duplicate payments.

3. LADWP did not provide its total turf removal commitment to WRM to be included in its FY2016/17 conservation budget. However, LADWP later submitted a request for turf removal rebate reimbursement in the amount of \$1.5 million and Metropolitan reimbursed LADWP from the moneys that were allocated to LADWP for water-efficient device incentives.

We recommend that WRM management modify its policies and procedures to address the noted deficiencies.