



Internal Audit Report for September 2017

Summary

Two reports were issued during the month:

- 1. External Affairs Consulting Agreement – Quigley-Simpson & Heppelwhite, Inc. (151967)**
- 2. Accounts Receivable and Cash Receipts**

Discussion Section

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

Background

The External Affairs Group is responsible for Metropolitan's communication, public outreach and education, legislative, and innovation activities. During a period when water issues and a historic drought continued to dominate the region's water resource dialogue, expanded efforts were made to provide information, advocacy, and education. Accordingly, External Affairs enhanced outreach to educate the public on water issues and raise awareness on conservation efforts throughout Southern California. These efforts included targeting specific socio-economic and ethnic groups through an advertising and outreach campaign. The use of media consultants and creative services were critical in leveraging their expertise in designing, producing, and delivering this content.

Accordingly, in January 2015, the Board authorized a water awareness and conservation advertising campaign with a budget not to exceed \$5.5 million. The Board also authorized staff to initiate a request for proposals (RFP) for consulting and creative services, supported by digital, print, broadcast, and social media. Moreover, they directed staff to develop outreach activities for a culturally diverse campaign. Subsequently, Metropolitan issued RFP PL-1089 for Water Awareness and Conservation Advertising services and they received twelve respondents. Quigley received the highest score by the selection committee and was awarded a one-year contract effective from March 16, 2015 through March 15, 2016 with a maximum payable of \$5.5 million.

Quigley began the "Let's All Take a Turn," (Turn) campaign to increase water conservation and heighten public awareness of the drought and water issues using television, radio, billboards and other outdoor signs, digital advertising, social media and community events. For the first time, the campaign was translated in Spanish, Chinese, Korean and Vietnamese to reach a culturally diverse audience.

On February 9, 2016, the Board authorized a \$2.2 million extension to the Turn campaign adding additional messaging around a new trademarked logo of “H2Love” and the tagline “Love Water, Save Water”. The campaign included media coverage through radio live reads, paid advertising in 53 community newspapers, digital and online advertising, social media postings, customized materials, and community outreach events. A new component in the campaign was the official sponsorship with the Major League Soccer team, LA Galaxy. This partnership provides digital signage at the StubHub Center, exhibit booths staffed by Metropolitan at four home games, social media videos, Facebook Live events and joint outreach activities with the LA Galaxy community.

Finally, on January 1, 2017, the Board authorized an extension of the contract through March 15, 2018 and increased the maximum payable by \$1.3 million in FY2016/17 and \$3.5 million in FY 2017/18 to a total amount not to exceed \$12.5 million. The goal is to continue the successful paid advertising and outreach campaign during the winter and spring months. The campaign funds will be used for major media buy to present updated H2Love multilingual messages on billboards, transit sign and bus wraps, and messages on water conservation using social media components. As of May 30, 2017, payments made to Quigley totaled \$8.3 million.

Opinion

In our opinion, the accounting and administrative procedures over Quigley 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 March 16, 2015 to May 30, 2017.

Comments and Recommendations

COMPLIANCE WITH AGREEMENT TERMS

Compliance with contractual requirements is necessary to ensure accurate accounting records, proper supporting detail, and adequate control over the administration of the agreements. Furthermore, compliance with the contracts' terms and conditions also ensures that parties fully discharge their duties and obligations and exercise their legal rights associated with the agreements.

We reviewed twenty six invoices totaling \$4.7 million paid between March 2015 and May 2017. We noted two invoices that included charges for activity performed more than 90 days prior to the invoice date. This is in contrast to the Billing and Payment section of the agreements that requires services to be billed within 90 days from the date that the work was performed.

Failure to comply with the terms and conditions of the agreements could result in financial loss to Metropolitan due to erroneous, fraudulent or unauthorized transactions.

We recommend that agreement administrators remind the consultants to comply with the terms and conditions of their agreements. Further, we recommend that management continue to conduct periodic review to ensure compliance with the contractual terms and conditions.

Accounts Receivable and Cash Receipts

Background

Metropolitan's principal source of operating revenue is from water sales, which include all revenues received from charges for the sale and availability of water, including water rates, readiness-to-serve charges, capacity charges and hydroelectric power sales. Non-operating revenue includes ad valorem property taxes, investment income, and rental income. For the twelve months ended March 31, 2017, operating revenues totaled \$1.37 billion whereas non-operating revenues totaled \$123.7 million. In addition, accounts receivable totaled \$185 million as of this date.

Opinion

In our opinion, the accounting and administrative procedures over Accounts Receivable and Cash Receipts 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 July 1, 2012 through March 31, 2017.

Comments and Recommendations

REMITTANCE POLICIES AND PROCEDURES

Prudent business practices dictate that checks received through the mail are opened in a controlled environment and are deposited promptly. These broad concepts provide assurance of the propriety and accuracy of the cash receipting process. However, steps should be taken to limit the number and amount of checks received through the mail by moving the transfer of funds from physical checks to automated processes such as direct deposit, lockbox, ACH, and wire transfers.

Our audit scope consisted of a review of cash remittances received between April 2016 and March 2017. During this period, 1,400 checks totaling \$62 million were processed. Moreover, we noted that sixty two of these items were for amounts greater than \$100,000 and totaled \$54 million (88%) of the amount received. Further review revealed that these checks were made up of water sales, property taxes, reimbursable projects and the annual OPEB premium reimbursement.

Metropolitan's Operating Policy C-09 establishes policies for collecting, reporting, and handling remittances. These policies authorize receiving agents at Union Station Headquarters and Field Offices to accept and process these items. In addition, the Controller's Office developed written procedures for processing cash remittances. Our review of these policies and procedures revealed a lack of specificity and clarity necessary to provide guidance to employees. Furthermore, our review of the volume/dollar amount of cash receipts revealed significant risk existed in the fact that large dollar remittances for water sales and property taxes were received in check form through the mail that required manual processing.

Failure to maintain accountability over checks received may result in payments not being processed on a timely basis. Furthermore, manual processing of check remittances could result in a loss if these items are lost or misappropriated.

We recommend that management revise policies to restrict the processing of cash remittances to specific individuals and provide detailed operating procedures for these personnel. These procedures should include compensating controls such as separation of duties or control totals that are designed to ensure the accuracy, completeness, and timeliness of the cash receipting process.

Consideration should also be given to instruct member agencies to utilize automated funds transfer services to facilitate the remittance process. Moreover, requests should be made to federal and state funding agencies that they utilize these automated systems to mitigate risk and to encourage the efficient transfer of funds.