



THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

Report
Office of General Auditor

Internal Audit Report for July 2019

Summary

Two reports were issued during the month:

- 1. Consulting Agreements - Power Tech Engineers, Inc. and GGS CA Inc. Audit Report**
- 2. Audit Quality Assurance – Self-Assessment Review**

Discussion Section

This report highlights the significant activities of the Internal Audit Department during July 2019. 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.

Consulting Agreements - Power Tech Engineers Inc. and GGS CA Inc. Audit Report

The Audit Department has completed a review of the accounting and administrative controls over the consulting agreements with Power Tech Engineers, Inc. ("Power tech," 125206) and GGS CA Inc. ("GGS," 173287) as of December 31, 2018.

Scope

Our review consisted of evaluating the internal controls over the agreement administration and reporting practices, and testing compliance with the terms and conditions of the agreements. In addition, we evaluated the validity and propriety of invoice payments for assurance that the amounts billed were properly calculated and adequately supported.

Background

The Hiram W. Wadsworth (Wadsworth) pumping plant was built in early 2000 and is located on the west end of Diamond Valley Lake (DVL) near the city of Hemet. This pumping/hydro-generation facility is a major control structure and renewable energy producer for water coming from the State Water Project through DVL.

Before arriving at Wadsworth, the water in DVL has flowed south from the State Water Project into the reservoir via the Inland Feeder and the Eastside Pipeline. These supplies are eventually released to the conveyance and distribution system. DVL's Inlet/Outlet Tower is utilized to

either fill or release water from the reservoir and has valves at nine different depths, providing operators with the flexibility to select the best quality water.

Water flows from the lake through a 2,300-foot-long pressure tunnel to Wadsworth, where it is sent through as many as nine electrical generators that produce up to 3.3 megawatts each. From there, water is released to the San Diego Canal, through which it flows to Metropolitan's Lake Skinner and Robert A. Skinner Water Treatment Plant, and other water facilities in southwestern Riverside and San Diego Counties. What is produced by the Wadsworth generator units (up to 30 million kilowatt-hours a year) can be sold by Metropolitan as renewable energy.

The water pressures and flows between DVL, the Inland Feeder and the canal are managed by the pressure control, monitoring and electrical protection systems at Wadsworth. This system includes pressure control valves, programmable logic controllers, the data and control communications system, pump/generator vibration monitoring system and pump/generator power control components. An initial investigation of the system in 2010 revealed that these components were failing due to its outdated technology and rehabilitation of the system was promptly needed. As a result, the Metropolitan Board authorized the upgrade to the system under appropriation 15467.

Accordingly, Metropolitan entered into a sixteen month agreement with GGS (173287) as an integrator and equipment supplier for the Wadsworth control and protection system upgrade. This agreement is in effect from September 1, 2017 through February 29, 2020, with a maximum payable of \$15,993,000 million. Payments to GGS from contract inception through December 2018 totaled \$9,567,885 million. Previously Metropolitan had a one year agreement with GGS (126790) as a prime consultant to provide preliminary design and final design for the Wadsworth control and protective system upgrade. This agreement had four amendments extending the contract and adding the final design to the project scope with a maximum payable to \$7 million and was effective from April 1, 2012 through August 31, 2017 with \$6,495,040 million paid to GGS.

In addition we also reviewed the consulting agreement with Power Tech (125206) which was entered to provide technical oversight for the full scale upgrades, and other deliverables produced by, GGS, the integrator and equipment supplier for the Wadsworth control and protection system upgrade. This agreement was entered in April 2012, and has been amended seven times to extend the time period and increase the maximum payable. This agreement is valid until December 30, 2019 and the maximum payable under the contract is \$1,974,000 million. As of December 2018 payments to Power-tech totaled \$1,592,664 million.

Opinion

In our opinion, the accounting and administrative procedures over consulting agreements with Power Tech and GGS 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 September 2017 through December 2018.

Comments and Recommendations

None

Audit Quality Assurance – Self-Assessment Review

Background

Internal Audit (the Department) implemented a Quality Assurance and Improvement Program (QA&IP) in 2007. The purpose of the QA&IP is to help ensure the Department continues its contribution to the Metropolitan Water District (the District) risk management, control and governance efforts. The principles behind the QA&IP are set forth in The Institute of Internal Auditors (IIA) International Standards for the Professional Practice of Internal Auditing (the *Standards*). Compliance with the *Standards*, which include the Definition of Internal Auditing and the IIA Code of Ethics, helps ensure the department provides independent, objective professional services to help the District achieve its objectives.

The QA&IP is a comprehensive assessment of the Department's governance, audit staff, management and audit process. Individual elements of the QA&IP include policies and procedures, training and improvement activities, annual internal self-assessments, and external assessments performed by an independent third party every five years.

In May 2017, the IIA performed an external Quality Assurance Review and judged the Department to be in "General Compliance" with the *Standards*, the highest possible rating. The next external assessment will be due in 2022.

This report is based upon an internal assessment and assesses the Department's compliance as of June 2018 using the methodology outlined in the *IIA's 2017 Quality Assessment Manual for the Internal Audit Activity*. The broad objectives of this review were to:

- Assess conformity to the *Standards* and Code of Ethics
- Assess effectiveness in carrying out the Department's mission, as set forth in the Audit Department Charter
- Identify opportunities to strengthen the Department's value to the District

The self-assessment involves a thorough evaluation of each of the *Standards* which includes the related 41 sub-components. In performing this work, we assessed governance processes and reviewed both the Audit and Ethics Committee and Internal Audit Department Charters as well as Department policies and procedures against the *Standards*. The review encompassed all components of the audit function. It included a review of risk assessment, audit planning, field performance, and staff supervision. In conducting the examination, we reviewed a sample of audit workpapers and final reports in order to evaluate adherence to aforementioned policies and procedures. Moreover, we also surveyed clients and audit staff to identify strengths and to look for opportunities for improvement. Finally, we reviewed Board and management communications for completeness and examined management responses for propriety.

Conclusion

The Department “Generally Conforms” to the *Standards* and the Code of Ethics. For a detailed list of conformance with individual *Standards* and the Code of Ethics, please see attachment A.

The *IIA’s 2017 Quality Assessment Manual for the Internal Audit Activity* suggests three possible ratings: “Generally Conforms”, “Partially Conforms,” and “Does Not Conform.” “Generally Conforms”, the highest rating, means that an internal audit activity has a charter, policies and processes that conform to the *Standards* and the Code of Ethics.

The Audit Department is well structured and enlightened with regard to the *Standards* and Code of Ethics. Management endeavors to implement appropriate practices. The observations and recommendations below are intended to build on the foundation already in place.

Recommendations for the Internal Audit Activity

1. Engagement Work Program

A well designed audit program assists in the achievement of audit objectives. IIA Standard 2240 requires “work programs to include procedures for identifying, analyzing, evaluating, and documenting information during the engagement. The work program must be approved prior to its implementation, with any adjustments approved promptly.” Additionally, IIA Standard 1220 states “that internal auditors consider the use of technology based audit and other data analysis techniques” and IIA Standard 2120 requires “the internal audit department to evaluate the potential for the occurrence of fraud and how the organization manages fraud risk.”

Audit workpapers are maintained in TeamMate, one of the industry’s leading audit management software systems. We reviewed the workpaper files for eight internal audit projects; five of the audit programs were limited in procedures and four had limited to no data analysis performed or considered.

Additionally, for four of the eight projects reviewed, the fraud analysis was limited to inquiry of department personnel with an additional two including minimal fraud analyses. For those that contained limited fraud analysis, none had clear linkage to the work program.

For four of the projects, the work program did not reflect timely review prior to the start of fieldwork and in five projects the audit steps in the control matrix did not agree to the audit steps performed. Evidence of approval of changes could not be located.

Engagement work programs that are not well developed and executed may result in unachieved audit objectives, failure to identify crucial audit evidence, and in a less thorough and effective review.

Recommendation

Project work programs should be enhanced to include all established elements as outlined in the IIA *Standards*. Consideration should be given to adding available tools to the audit teams' resources such as on-line audit libraries and data analytic software. Review of work programs should occur prior to the start of fieldwork. Changes to the work program mid-stream should be adequately documented and traceable within the project files.

2. Documenting Information

Thorough and proper workpapers enable qualified individuals to re-perform audit procedures, duplicate results, and in the process evaluate audit quality. IIA Standard 2320 states that "conclusions and engagement results must be based on appropriate analyses and evaluations" and IIA Standard 2330 states that "sufficient, reliable, relevant and useful information must be documented to support the engagement results and conclusions". In addition, Department policies and procedures require each workpaper to be "descriptive enough to stand on its own without questions from the reader".

We reviewed workpaper files for eight internal audit projects. Five of the eight workpaper files we examined did not meet Department standards. In these instances, workpapers were hard to follow as they lacked sufficient details and/or supporting documentation necessary to be easily understood and to duplicate the preparer's conclusions.

Audit work that is not clearly and thoroughly documented makes supervisory review more difficult and time-consuming. Incomplete workpapers prevents qualified individuals from independently re-performing audit procedures in order to duplicate results and corroborate conclusions.

Recommendation

Internal audit staff should comply with Department standards. Audit staff should ensure that work is adequately documented with sufficient, reliable information to support engagement results and conclusions.

3. Engagement Supervision

IIA Standard 2340 requires engagements "to be properly supervised to ensure objectives are achieved, quality is assured, and staff is developed". Additionally, Department policy requires audit management to review and approved work progress at specific points in the audit.

The General Auditor reviews each internal audit report prior to issuance, asking questions of the audit team and editing the report as necessary. Interviews with audit management and review of the project files reflected that reviews are not being consistently performed at the appropriate time. Our examination revealed that for all projects reviewed, reviews and approvals are not consistently documented for significant sections of the audit and those documented were not consistently completed on a timely basis. In addition, when changes

were made by staff after an initial review was complete, a secondary review did not consistently occur. Furthermore, when review notes were provided, there was no evidence of remedial action.

Late or incomplete work reviews can adversely affect audit quality, stifle staff development, delay final report issuance, and hinder quality assurance efforts. Failure to document work product reviews does not allow for a transparent independent assessment of supervisory involvement.

Recommendation

Although oral discussions provide value to staff, audit management should augment this process with formal documented reviews on a timely basis. Specifically:

- Reviews should be documented in the project file when performed.
- Reviews should occur as soon as possible after each major section of a project.
- All workpapers should be reviewed before the final report is submitted to the General Auditor.

Staff members should ensure to communicate with audit management when workpapers are ready for review, including when updates are made after the initial review. Review notes should be addressed within the project file and include actions taken to address comments made.

4. Audit Time Management

IIA Standard 2030 requires the chief audit executive to “ensure all internal audit resources are appropriate, sufficient, and effectively deployed to achieve the approved plan”.

The Audit Department Annual Audit Plan is both a compilation of the audit universe and a proposed schedule for the upcoming fiscal year. Audit time is tracked by the hour and a 200 or 250 hour placeholder is assigned to recurring audits. As audit planning and fieldwork advance, staff is responsible for time management and budget constraints. Accordingly, staff can initiate a budget increase request that discusses the need for additional audit hours. In this appeal, staff must justify the increase by reconciling the hours requested against the cost/risk of not approving the budget change.

Recommendation

Future Annual Audit Plans should consider establishing more accurate budgets for recurring audits based on past experiences and current risk assessments.

5. Policies and Procedures

IIA Standard 2040 requires the chief audit executive to “establish policies and procedures to guide the internal audit activity.”

The Department has an excellent Policies and Procedures manual. However, it has not been updated to consider the current IIA *Standards*.

Policies and procedures provide management with guidelines for consistent performance of daily operations. They also facilitate training of new employees and serve as a reference for experienced personnel. Outdated policies and procedures may result in inconsistent performance and reduce the effectiveness of employee training.

Recommendation

Update Department Policies and Procedures to reflect current IIA *Standards* and practices.

6. Audit Department Charter (Department Charter)

The purpose, authority, and responsibility of the internal audit activity must be formally defined in an internal audit charter. IIA Standard 1000 states the charter is to be “consistent with the Mission of Internal Audit and the mandatory elements of the International Professional Practices framework (the Core Principles for the Professional Practice of Internal Auditing, the Code of Ethics, the *Standards*, and the Definition of Internal Auditing)”. The chief audit executive must periodically review the internal audit charter and present the charter to senior management and the board for approval. IIA Standard 1010 recommends the Mission of Internal Audit and the mandatory elements of the International Professional Practices Framework (IPPF) be discussed with senior management and the board.

Additionally, Internal Audit must be free from interference in determining the scope of internal auditing, performing work, and communicating results. IIA Standard 1100 requires the chief audit executive to “confirm to the board, at least annually, the organizational independence of the internal audit activity”.

The Department Charter is established in Article 4 of MWD Administrative Code. With the implementation of the 2017 International Professional Practices Framework (IPPF), recent revisions to the IIA Standards have occurred. However, the current *Standards* are not reflected in the existing Department Charter. Additionally, some language in the Charter may not be applicable, such as the compliance with Government Auditing Standards (GAGAS).

An outdated Department Charter may result in confusion and misunderstanding, and make it more difficult to comply with IIA *Standards*.

Recommendation

The Department Charter should be revised to reflect the most recent IIA *Standards*. In making revisions, consideration should be given to the IIA’s 2017 model Internal Audit Activity Charter. Revisions should be included in MWD’s Administrative Code and formally approved by the Board.

The Department Charter and mandatory elements of the IPPF should be reviewed annually by the Audit and Ethics Committee. The organizational independence of the Internal Audit department should be formally communicated, annually, to the Board.

7. Audit and Ethics Committee Charter

The Audit & Ethics Committee Charter provides specific guidance concerning the committee's duties and responsibilities. MWD's Audit and Ethics Committee Charter is established in Article 1, Section 2501 of the Administrative Code; however, it does not reflect changes as proposed by the IIA *Standards*.

Recommendation

Consider revising the Audit and Ethics Committee Charter to more fully define the committee's role and responsibilities in promoting effective organizational governance. The IIA's Implementation Guide IG1000 provides context for such an action and the IIA's Model Audit Committee Charter provides content suggestions.

8. Code of Ethics

The IIA has a Code of Ethics by which audit departments are required to abide. The Code of Ethics ("Code") states the principles and expectations governing the behavior of individuals and organizations in the conduct of internal auditing. The Code describes the minimum requirements for conduct and behavioral expectations. The purpose of the Code is to promote an ethical culture in the profession of internal auditing.

The Code requires that the policy be communicated to and understood by internal audit personnel and that there is evidence supporting the communication and understanding. Currently, the IIA Ethics Code is not formally acknowledged by Internal Audit staff. The Code has been discussed and reviewed at department meetings.

Recommendation

Formally document the review and understanding of the IIA Code of Ethics with department staff. Consider incorporating into the on-boarding process of new staff members.

9. Continuing Professional Education

IIA Standard 1230 requires internal auditors to "enhance their knowledge, skills, and other competencies through continuing professional development". Department policies and procedures require professional staff to complete 80 hours of CPE every two years. Staff members holding professional designations and licenses, such as Certified Internal Auditor (CIA), Certified Information System Auditor (CISA), Certified Fraud Examiner (CFE) and Certified Public Accountant (CPA), are required to meet minimum CPE standards in order to maintain their credentials.

Department training records for the period of July 2017 – June 2018 revealed that only two professional staff members obtained the required minimum CPE. Four professional staff members reported less than half the required number of hours and all remaining staff members reported less than 6 hours of continuing education. Survey results indicated clients believe that it would benefit internal audit staff and management to stay up to date with changes in the District's business, the industry, and relevant regulatory issues.

If staff members do not meet the minimum CPE standards their skills may become outdated. This may adversely impact audit quality and the Department's ability to comply with the IIA *Standards*. Those holding professional designations and licenses may jeopardize their credentials.

Recommendation

To help ensure audit staff members complete the amount and type of CPE they need, staff members should develop an annual training plan. Training plan progress and completion should be monitored and become a component of each staff member's performance evaluation. Audit staff members that do not currently hold a certification of license should be encouraged to obtain one.

Observations of Best Practices

In developing a strategic plan and vision statement, the General Auditor conducts extensive conversations with senior management and the Board. He also researches emerging trends and techniques and reviews numerous Global Audit Committee surveys and studies. There is an opportunity to enhance this process by using the IIA's Global Audit Information Network ("GAIN") Benchmarking Tool. The GAIN Benchmarking Tool permits comparisons with audit departments of similar size, experience and other metrics for the Department's peer group.

ATTACHMENT A

(GC= Generally Conforms, PC=Partially Conforms, DNC=Does Not Conform)

		GC	PC	DNC
Overall Evaluation		X		
Attribute Standards (1000 through 1300)		GC	PC	DNC
1000	Purpose, Authority, and Responsibility	X		
1010	Recognizing Mandatory Guidance in the Internal Audit Charter		X	
1100	Independence and Objectivity	X		
1110	Organizational Independence	X		
1111	Direct Interaction with the Board	X		
1112	Chief Audit Executive Roles Beyond Internal Auditing	X		
1120	Individual Objectivity	X		
1130	Impairment to Independence or Objectivity	X		
1200	Proficiency and Due Professional Care	X		
1210	Proficiency	X		
1220	Due Professional Care	X		
1230	Continuing Professional Development		X	
1300	Quality Assurance and Improvement Program	X		
1310	Requirements of the Quality Assurance and Improvement Program	X		
1311	Internal Assessments	X		
1312	External Assessments	X		
1320	Reporting on the Quality Assurance and Improvement Program	X		

1321	Use of “Conforms with the <i>International Standards for the Professional Practice of Internal Auditing</i> ”	X		
1322	Disclosure of Nonconformance	X		
Performance Standards (2000 through 2600)		GC	PC	DNC
2000	Managing the Internal Audit Activity	X		
2010	Planning	X		
2020	Communication and Approval	X		
2030	Resource Management	X		
2040	Policies and Procedures	X		
2050	Coordination and Reliance	X		
2060	Reporting to Senior Management and the Board	X		
2070	External Service Provider and Organizational Responsibility for Internal Auditing	N/A		
2100	Nature of Work	X		
2110	Governance	X		
2120	Risk Management	X		
2130	Control	X		
2200	Engagement Planning	X		
2201	Planning Considerations	X		
2210	Engagement Objectives	X		
2220	Engagement Scope	X		
2230	Engagement Resource Allocation	X		
2240	Engagement Work Program		X	
2300	Performing the Engagement	X		
2310	Identifying Information	X		

2320	Analysis and Evaluation	X		
2330	Documenting Information	X		
2340	Engagement Supervision			X
		GC	PC	DNC
2400	Communicating Results	X		
2410	Criteria for Communicating	X		
2420	Quality of Communications	X		
2421	Errors and Omissions	X		
2430	Use of “Conducted in Conformance with the <i>International Standards for the Professional Practice of Internal Auditing</i> ”	X		
2431	Engagement Disclosure of Nonconformance	X		
2440	Disseminating Results	X		
2450	Overall Opinions	X		
2500	Monitoring Progress	X		
2600	Communicating the Acceptance of Risks	X		

Code of Ethics		GC	PC	DNC
	Code of Ethics	X		