THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

Internal Audit Report for April 2020

Summary

Two reports were issued during the month:

1. **Procurement Card (P-Card) and Travel Card Programs Audit Report**
2. **Audit Research Project – Capital Investment Plan (CIP)**

Discussion Section

This report highlights the significant activities of the Internal Audit Department during April 2020. 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.

Procurement Card (P-Card) and Travel Card Programs Audit Report

The Audit Department has completed a review of the accounting and administrative controls over the Procurement Card (P-Card) and Travel Card Programs as of January 31, 2019.

Scope

Our review consisted of an evaluation of the administration of the P-Card and Travel Card Programs. Specifically, we tested P-Card and Travel Card authorization and examined the propriety and accuracy of charges for selected transactions. Finally, we analyzed expense trends to identify unusual patterns of transactions warranting further follow-up.

Background

A P-Card is a company charge card that allows cardholders to acquire goods and services without using the traditional purchasing/requisition process. P-Card usage facilitates and expedites small transactions, reduces the number of invoices processed by Accounts Payable, and minimizes petty cash disbursements. As of March 15, 2019, there were 232 cardholders with varying spending limits and merchant category code restrictions.

Metropolitan processes P-Card transactions through Bank of America and utilizes the P-Card Web Solution system to track purchases and reconcile payments. The P-Card Administrator in the Administrative Services Section oversees the program by analyzing cardholder activity and monitoring the status of monthly reconciliations. Cardholders are responsible for the physical security of their P-Cards, maintaining purchase documentation, recording transactions to the proper accounts, and reconciling monthly statements. The P-Cardholder Managers select cardholders, assign credit limits, review and approve transactions, verify compliance with policies and procedures, and monitor monthly statement reconciliations.

Employees who frequently travel on Metropolitan business use a Travel Card for expenses such as lodging, meals, and transportation. The Travel Card is similar to the P-card but is restricted to travel expenditures. Currently, 11 employees hold Travel Cards with varying spending limits. Cardholders submit expense reports, including itemized receipts, in the Oracle I-Expenses module following Metropolitan's travel policy.

P-Card activity for the three years ending in fiscal year 2018/19 was as follows:

Fiscal Years	2016/2017	2017/2018	2018/2019
# of Transactions	20,464	21,777	24,091
Total Amount	$10,179,300	$10,736,300	$11,507,977

Opinion

In our opinion, the accounting and administrative procedures over the P-Card and Travel Card Programs 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, 2015, through January 31, 2019.

Comments and Recommendations

POLICIES AND PROCEDURES

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

During our review, we noted the following exceptions to policies and procedures:

1. Thirty-four cardholders paid seminar/training registration fees using P-Cards not authorized for those transactions.
2. The P-Card Administrator requires cardholders to take refresher training every two years; however, the P-Card manual does not specify this requirement. We found 91 P-Card holders who had not completed refresher training within the past two years.
3. Training records for P-Card holders and approvers were not up to date. For example, we found training records for three individuals who no longer had P-Cards.

Failure to thoroughly document policies and procedures and keep them current may result in inconsistent P-Card usage. Failure to follow established policies and procedures may expose Metropolitan to potential financial loss or adversely affect management decisions.

We recommend that Procurement Management periodically update P-Card and policies and procedures and take steps to ensure compliance.

REVIEW AND APPROVAL

Review and approval controls serve to protect against unauthorized, inaccurate, or duplicate transactions; identify items that require correction; and ensure that follow-up procedures exist for exceptions.

We examined 60 P-Card and Travel Card transactions, totaling $220,640, posted between July 1, 2015, and January 31, 2019, and noted the following:
- Five P-Card holders approved their own expenditures.
- A Group Manager approved his own request for a Travel Card.
- In May 2017, Metropolitan paid two P-Card charges of $975.24 each. The cardholder, who retired in 2018, claimed both charges were fraudulent. The bank refunded one charge, but not the other.
- One of 60 transactions included an overcharge of $198, which the vendor refunded in May 2019 upon request.

Inadequate or inappropriate review and approval of cardholder transactions could result in financial loss to Metropolitan.

We recommend new procedures to prevent employees from approving their own transactions. Additionally, management should obtain a refund of the alleged $975.24 fraudulent charge if possible.

COMPLIANCE WITH USE TAX REGULATIONS

California Department of Tax and Fee Administration Publication 217 requires that all entities pay use tax on items purchased outside the state if the buyer uses them in California. If the seller does not collect the tax, the buyer is still obligated to pay it. The P-Card Administrator and the Accounts Payable Coordinator should ensure that Metropolitan pays the use tax on all P-Card purchases subject to the regulation.

In March 2017, Metropolitan paid the California Department of Tax and Fee Administration $209,249 as the result of an audit of the period July 1, 2010, to June 30, 2013. The payment included $160,418 in underpaid use tax and interest of $48,831. Management informed us that a substantial portion of the additional assessment related to transactions without receipts. During our review, we could not locate supporting documents for seven of the 60 P-Card transactions. All of the missing receipts belonged to separated or transferred MWD employees.

Failure to comply with the use tax regulations could result in inaccurate financial reporting and financial loss to Metropolitan.

We recommend that the Controller work together with the IT Database Manager and Procurement Manager to ensure use tax is paid correctly at the time of purchase. We also recommend that Procurement Management implement a centralized, paperless repository for all P-Card transactions.

COMPUTER SOFTWARE LIFECYCLE

The 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 not be installed until testing is complete, and general release versions are available. Moreover, software should be uninstalled and abandoned when product support ends, and the developer no longer provides fixes, updates, or technical assistance.

During our review, we noted the P-Card Web Solution system was running on the Windows Server 2008 operating system, which Microsoft no longer supports.

Reliance on unsupported operating system platforms may compromise operations as a result of system instability, unresolved security vulnerabilities, or known software flaws. End-of-life software also faces amplified security risks as known weaknesses provide easy targets for exploitation, and the absence of security updates and source code innovations limit preventive and detective controls.

At the time of our audit, Procurement Management was aware of the deficiency noted above and was already exploring alternatives. A cloud-based solution, compatible with Windows 10, has been identified and will be implemented in FY 2020-21.

Audit Research Project – Capital Investment Plan (CIP)

A critical component of Internal Audit's on-going effort to provide independent, objective assurance and consulting services to Metropolitan involves assessing risk. Essential to that process is developing a thorough understanding of the risk universe and its principal components. One critical element of Metropolitan's risk universe is its Capital Investment Plan (CIP), budgeted for $260 million in FY 2019/20.

As part of a limited scope, non-audit research project, Internal Audit completed a comprehensive study to confirm and expand our understanding of the statutory requirements, Administrative Code, policies, procedures, and internal controls governing CIP. In doing so, we worked with management and staff from Engineering Services, Ethics, and the Controller's Office. We developed and updated detailed flowcharts for each phase of the CIP process, including project initiation, planning, design, bidding and awarding contracts, project management, close-out, contractor billing, payment, recording, and reporting.

Because a shared understanding of the CIP process is essential to effective internal control, our flowcharts have been provided to and discussed with key stakeholders and will be periodically revised, as necessary. Finally, Internal Audit will use this work to confirm that critical controls are operating effectively on each of our CIP audits.