



**AUDIT COMMITTEE MEETING
OF THE BOARD OF DIRECTORS
INLAND EMPIRE UTILITIES AGENCY*
AGENCY HEADQUARTERS, CHINO, CA 91708**

**MONDAY, MARCH 12, 2018
9:00 A.M.**

CALL TO ORDER

PUBLIC COMMENT

Members of the public may address the Board on any item that is within the jurisdiction of the Board; however, no action may be taken on any item not appearing on the agenda unless the action is otherwise authorized by Subdivision (b) of Section 54954.2 of the Government Code. Those persons wishing to address the Board on any matter, whether or not it appears on the agenda, are requested to complete and submit to the Board Secretary a "Request to Speak" form, which is available on the table in the Board Room. Comments will be limited to five minutes per speaker. Thank you.

ADDITIONS TO THE AGENDA

In accordance with Section 54954.2 of the Government Code (Brown Act), additions to the agenda require two-thirds vote of the legislative body, or, if less than two-thirds of the members are present, a unanimous vote of those members present, that there is a need to take immediate action and that the need for action came to the attention of the local agency subsequent to the agenda being posted.

1. ACTION ITEM

A. MINUTES

The Committee will be asked to approve the Audit Committee meeting minutes of December 11, 2017.

2. INFORMATION ITEMS

A. WIRE TRANSFERS AUDIT REPORT (WRITTEN/POWERPOINT)

B. PROCUREMENT CARD AUDIT (WRITTEN/POWERPOINT)

C. INTERNAL AUDIT DEPARTMENT QUARTERLY STATUS REPORT (WRITTEN)

3. GENERAL MANAGER'S COMMENTS

4. **AUDIT COMMITTEE ADVISOR COMMENTS**
5. **COMMITTEE MEMBER COMMENTS**
6. **COMMITTEE MEMBER REQUESTED FUTURE AGENDA ITEMS**
7. **ADJOURN**

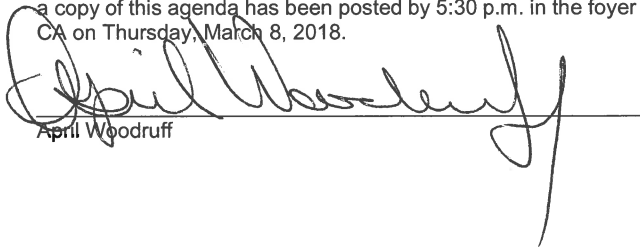
*A Municipal Water District

In compliance with the Americans with Disabilities Act, if you need special assistance to participate in this meeting, please contact the Board Secretary (909-993-1736), 48 hours prior to the scheduled meeting so that the Agency can make reasonable arrangements.

Proofed by: 

DECLARATION OF POSTING

I, April Woodruff, Board Secretary/Office Manager of the Inland Empire Utilities Agency, A Municipal Water District, hereby certify that a copy of this agenda has been posted by 5:30 p.m. in the foyer at the Agency's main office, 6075 Kimball Avenue, Building A, Chino, CA on Thursday, March 8, 2018.


April Woodruff

**ACTION
ITEM**

1A



**MINUTES
AUDIT COMMITTEE MEETING
INLAND EMPIRE UTILITIES AGENCY*
AGENCY HEADQUARTERS, CHINO, CA
MONDAY, DECEMBER 11, 2017
9:00 A.M.**

COMMITTEE MEMBERS PRESENT

Kati Parker, Chair
Steven J. Elie

COMMITTEE MEMBERS ABSENT

None

STAFF PRESENT

Joe Grindstaff, General Manager Emeritus
Halla Razak, General Manager
Randy Lee, Executive Manager of Operations
Javier Chagoyen-Lazaro, Manager of Finance & Accounting
Jason Gu, Grants Officer
Sally Lee, Executive Assistant
Laura Mantilla, Executive Assistant
Sapna Nangia, Senior Internal Auditor
Peter Soelter, Senior Internal Auditor
Christina Valencia, Executive Manager of Finance & Administration/AGM
Teresa Velarde, Manager of Internal Audit

OTHERS PRESENT

Debbie Harper, LSL
Travis Hickey, Audit Committee Advisor

The meeting was called to order at 9:01 a.m. There were no public comments received or additions to the agenda.

ACTION ITEMS

The Committee:

- ◆ Approved the Audit Committee meeting minutes of September 20, 2017.
- ◆ Recommended that the Board:
 1. Approve the Inland Empire Utilities Agency Comprehensive Annual Financial Report for fiscal year ended June 30, 2017; and
 2. Direct staff to distribute the report as appropriate, to the various federal, state, and local agencies, financial institutions, bond rating agencies, and other interested parties.

as a Consent Calendar Item on the December 20, 2017 Board meeting agenda.

- ◆ Recommended that the Board:

1. Approve the Single Audit Report for FY 2016/17; and
2. Direct staff to distribute the report, as appropriate, to the State Controller's Office, the Federal Audit Clearing House, and other interested parties.

as a Consent Calendar Item on the December 20, 2017 Board meeting agenda.

- ◆ Recommended that the Board reconfirm the Audit Committee Charter and the Internal Audit Department Charter and direct staff to implement the charters.

as a Consent Calendar Item on the December 20, 2017 Board meeting agenda.

INFORMATION ITEMS

The following information items were presented, received, or filed by the Committee:

- ◆ Payroll Operations Audit & Comparable Agencies' Survey
- ◆ Southern California Edison Utility Payment Follow Up Audit
- ◆ Internal Audit Department Standard Operating Procedures (SOP)
- ◆ Internal Audit Department Quarterly Status Report
- ◆ Audit Committee Financial Advisor Contract Extension

GENERAL MANAGER'S COMMENTS

The General Manager had no comments.

COMMITTEE MEMBER COMMENTS

There were no Committee Member comments.

COMMITTEE MEMBER REQUESTED FUTURE AGENDA ITEMS

There were no Committee Member requested future agenda items.

With no further business, the meeting adjourned at 9:50 a.m.

Respectfully submitted,

Sally Lee
Executive Assistant

*A Municipal Water District

APPROVED: MARCH 12, 2018

Audit Committee

**INFORMATION
ITEM
2A**

Date: March 21, 2018

To: The Honorable Board of Directors

From: Teresa Velarde, Manager of Internal Audit

Committee: Audit

03/12/18

Manager Contact: Teresa Velarde, Manager of Internal Audit

Subject: Wire Transfers Audit Report

Executive Summary:

Internal Audit (IA) completed the Wire Transfers Audit on March 1, 2018 to evaluate internal controls and segregation of duties for the initiation, authorization and fulfillment of wire transfer and EFT payments, to verify that transactions are accurate, complete and timely, and to identify improvements for the effectiveness and efficiency of processing transactions.

The audit found that effective controls are in place and opportunities exist to further strengthen internal controls and improve processes; the following summarizes the audit recommendations:

- Utilize electronic signature technology and digital approval documentation
- Update Wire Transfer Standard Operating Procedures (SOP)
- Evaluate cost/benefit of higher limits for Fraud Funds Transfer Insurance
- Develop standards for documentation and review of supporting information in SAP
- Prepare/update SOP's for electronic transactions related to investments

Staff's Recommendation:

Receive the Wire Transfers Audit report as an information item for the Board of Directors and instruct Agency staff to implement/resolve the audit recommendations.

Budget Impact *Budgeted (Y/N): Y* *Amendment (Y/N): Y* *Amount for Requested Approval:*

Account/Project Name:

N/A

Fiscal Impact (explain if not budgeted):

N/A

Prior Board Action:

On March 15, 2017, the Board of Directors reconfirmed the approved Audit Committee and the Internal Audit Department Charter.

On June 21, 2017, the Board of Directors approved the Annual Audit Plan for Fiscal Year 2017/18.

Environmental Determination:

Not Applicable

Business Goal:

The Wire Transfers Audit report is consistent with the Agency's Business Goals of Fiscal Responsibility, Workplace Environment and Business Practices by ensuring that the recommendations foster a strong control environment, and assist management in achieving organizational goals.

Attachments:

Attachment 1 - Wire Transfers Audit report



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TEL (909) 993-1600 • FAX (909) 597-8875
www.ieua.org

DATE: March 1, 2018

TO: Halla Razak
General Manager

Teresa V. Velarde

FROM: Teresa V. Velarde
Manager of Internal Audit

SUBJECT: Wire Transfers Audit

Audit Authority

The Inland Empire Utilities Agency (IEUA or Agency) Internal Audit Department (IA) performed an audit of wire transfer/electronic fund transfer (EFT) payments, policies, procedures and transactions for the period from July 1, 2016 through December 31, 2017. This audit was performed under the authority given by the IEUA Board of Directors and the Fiscal Year 2017/18 Annual Audit Plan. Attached is the report which discusses IA's observations and recommendations.

Audit Scope

The audit objectives were to:

- evaluate internal controls and segregation of duties for the initiation, authorization and fulfillment of wire transfer and EFT payments,
- verify that transactions are accurate, complete and timely, and
- identify improvements for the effectiveness and efficiency of processing transactions.

Audit Techniques Applied

Audit techniques applied during the audit included:

- Interviews of Agency staff
- Walkthroughs of processes and transactions
- Flowchart of the wire transfer process
- Review of supporting documents in SAP and in manual files
- Review of policies and procedures
- Review information in bank statements

Water Smart – Thinking in Terms of Tomorrow

Steven J. Elie
President

Michael E. Camacho
Vice President

Jasmin A. Hall
Secretary/Treasurer

Paul Hofer
Director

Kati Parker
Director

Halla Razak
General Manager

Audit Results - Executive Summary

The Finance and Accounting Department (FAD) is responsible for wire transfers and EFT transactions at the Agency and has established a variety of internal controls to ensure that these are authorized, supported, accurate, timely and valid. The audit found that FAD has effective controls in place. Detailed observations and recommendations are included in the attached report. IA found opportunities for improvement:

- Currently various manual approvals are required to ensure adequate segregation of duties and internal controls. As the Agency moves toward automated recordkeeping using Laserfiche and possibly other tools, the Agency should consider utilizing electronic signature technology and implementing digital approval documentation.
- FAD is in the process of updating Standard Operating Procedures to meet the most recent Agency format, according to A-51. FAD should finalize the new SOPs to ensure the most current guidance is available.
- The Agency currently has a Fraud Funds Transfer Insurance policy limit of \$2,000,000 per occurrence, but should consider a higher limit. The Insurance provides monetary reimbursement in the event of fraud. Concurrently, the Agency should consider reducing the bank call-back threshold of \$11,000,000 to any amounts that exceed the Agency's insurance policy limit to mitigate risks.
- FAD should develop standards for maintaining documentation and review of information in the automated accounting systems to ensure consistency and completeness.
- Investment-related wire transfers utilize a separate process and the process is changing with a new investment advisor. FAD should develop or update SOPs to document the new processes.

The Wire Transfers Audit is consistent with *the Agency's Business Goals of Fiscal Responsibility, Workplace Environment and Business Practices* by providing an independent evaluation of the internal controls, testing transactions and providing recommendations for improvement, cost containment and policy compliance.

Discussion with Management

Drafts of this audit report were provided to Christina Valencia, Executive Manager of Finance and Administration/Assistant General Manager, Javier Chagoyen-Lazaro, Manager of Finance and Accounting and Tina Cheng, Budget Officer on February 14, 27 and 28, 2018 for their review and comments prior to finalizing.

Acknowledgements

We would like to extend our appreciation to Finance and Accounting Department staff for their cooperation and assistance during this review.

Wire Transfers and Electronic Funds Transfer (EFT) Transactions

The Agency utilizes two types of electronic transactions:

- **Wire transfers, also known as Electronic Funds Transfer (EFT) transactions.** Wire transfers are often the most expedient method for transferring funds between bank accounts. Wire transfers are virtually instantaneous. The Agency utilizes two types of wire transfers:
 - **“Credit” EFT’s** are the most common. These wire transfers are processed by making a request for payment through messages to the Agency’s bank, primarily Citizen’s Business Bank (CBB) requesting CBB to issue a payment in accordance with the Agency’s instructions. The Agency uses wire transfers for transactions where no cash or check exchange is involved, and predetermined amounts are directly (electronically) transferred from the Agency’s CBB bank account to payees’ bank accounts. These wire transfers are utilized for large payments to vendors such as construction contractors, the monthly Metropolitan Water District payment and certain, generally non-recurring investment transactions during the bond repayment process. During this review, the amounts varied between \$1,200 (for payroll-related items) to \$51 million (unique bond repayment transaction).
 - **“Debit” EFT’s** are the other form of wire transfer. These are originated by the Agency and processed by authorizing the payee’s bank to process a predetermined transfer amount from the Agency’s account. For security reasons the Agency uses these wire transfers for a limited number of vendors including employment related payments to CalPERS and for Federal and State taxes.
- **Automated Clearing House (ACH) transactions:** ACH transactions are the electronic transfers of funds from the Agency’s bank account to a payee’s checking or savings account through the ACH Network, a highly reliable and efficient nationwide batch-oriented electronic funds transfer system. The National Automated Clearing House Association establishes the NACHA Operating Rules, the standards and procedures that enable participating depository financial institutions to exchange ACH payments on a national basis. Payee-payment records are sent in batches, and settlements do not occur until the next business day. These transactions are processed in batches by banks. The scope of this audit did not include an evaluation of payments through the ACH Network because the risk of issuing payments is considered low. The main risk lies with ensuring that only legitimate vendors are included in the Agency’s vendor master file. The scope of this review did not evaluate vendor files, only controls with wire transactions.

The following is a summary of the total Wire Transfers during our 18-month review period.

Time-Period	Number of Transfers	Total	Transfers over \$2Million	Average number of transfers per week	Average dollar amount of each transfer
7/1/16 - 12/31/16	126	\$ 103,266,036	10	4.85	\$ 819,572
1/1/17 - 6/30/17	142	\$ 118,165,505	7	5.46	\$ 832,151
7/1/17 - 12/31/17	107	\$ 52,819,729	10	4.12	\$ 493,642*

*Average dollar amount declined after Bond refinancing and pay-off.

Process

There are four steps that make up the electronic transactions process:

1. Authorization form
2. Transfer initiation
3. Transfer approval
4. Reconciliation

The processes vary slightly between “credit” and “debit” Wire Transfers.

Credit Wire Transfer/EFT Transactions:

Authorization form: This is the document that initiates all electronic transactions. The Agency’s Financial Analysts have pre-established templates for the various types of electronic transactions. For ACH and “credit” Wire Transfer transactions the template is addressed to Citizen’s Business Bank (CBB). The template provides an explanation of the type of transaction and the relevant details needed for processing. The Authorization form requires two signatures from individuals authorized by the Agency as bank signatories. The signature lines are pre-printed for the Executive Manager of Finance and Administration/Assistant General Manager and Budget Officer’s signatures, but could be authorized by any two Agency bank signatories (including Board Members and/or the General Manager).

Transfer initiation: After obtaining the two signatures on the Agency’s Authorization Form, the next step is initiation of the transaction. There are four Financial Analysts with responsibility for processing electronic transfer information. The four Financial Analysts rotate this responsibility on a weekly basis (this ensures that each Financial Analyst rotates through different weeks of the month during the year, meaning that they do not see the same transactions each period when processing is their responsibility).

Internal audit notes that rotating responsibilities is an internal control “best practice” and notes that this is a good control to have in place.

To initiate the transaction a Financial Analyst logs into the CBB portal with a separate log-in and password. After entering the transfer information, CBB confirms the validity of the entry with a code that the Financial Analyst must confirm with their own code shown on their pre-assigned FOB (small security hardware device with built-in authentication used

to control and secure access to network services and data provided by CBB). Each Financial Analyst has a FOB and keeps it locked when not in use. All wire transfer transactions are processed using the previously established templates.

Transfer approval: For the transaction to be processed, CBB requires a separate approval step. This approval responsibility is limited to the Executive Manager of Finance and Administration/Assistant General Manager, the Budget Officer and the Manager of Finance and Accounting, one of whom must individually log-in to the CBB portal and execute their approval. These approvers do not have access to the CBB "FOB's" that the Financial Analysts use when initiating transfers and therefore, cannot make changes to the transactions initiated by the Financial Analysts.

Reconciliation: After completing the transactions, the files are returned to accounting staff for recording and reconciling in SAP and with the bank statement.

Debit Wire Transfer/EFT Transactions

Authorization form: Debit Wire Transfer transactions utilize the same authorization form as Credit Wire Transfers, except there is no addressee, since the Agency performs the transaction within the recipient's banking portal (ie. Federal and State tax authorities and to CalPers). The form still requires the same approval signatures.

Transfer initiation: Debit Wire Transfer transactions are initiated by the upload of the Payroll file. This initiation is performed by the Payroll Department as part of their routine bi-weekly payroll processing.

Transfer approval: The processing of Debit Wire Transfer transactions is complete once the Financial Analyst has logged into the bank portal for the recipient institution and validated the transaction. This is sufficient, since the transaction was initially uploaded to that institution through the payroll department as part of their normal responsibilities. That, along with the sign-off on the authorization letter constitute adequate authorization for the Financial Analysts to complete the transactions.

Reconciliation: After completing the transactions, the files are returned to accounting staff for recording and reconciling in SAP and with the bank statement.

Observation #1: The process of obtaining approvals to ensure segregation of duties requires multiple manual steps.

The process of obtaining the various required manual signatures indicating approvals can be streamlined to improve efficiency through automation. The Agency is moving toward utilizing automated recordkeeping using Laserfiche and possibly other electronic signature technology tools that meet Federal requirements for accuracy, authenticity and documentation. These tools provide immediate digital approval documentation and eliminate manual processes.

Recommendation #1:

As the Agency moves toward automated recordkeeping using Laserfiche and possibly other tools, the Agency should consider utilizing electronic signature technology and implementing digital approval documentation.

DEPARTMENT RESPONSE: The Agency is in the process of selecting a vendor to provide maintenance for the new Laserfiche program. The requirements include making a recommendation for digital signatures.

Observation #2: FAD is in the process of updating Standard Operating Procedures (SOP's) to the most recent Agency format.

Wire transfers include the largest transactions (in terms of monetary transactions) that the Agency processes. To ensure accurate, timely processing and to provide training tools, it is important that SOP's are up-to-date.

Recommendation #2:

FAD should finalize the new SOPs in the format provided in Agency Policy A-51.

Controls provided by Citizen's Business Bank

IA noted that in addition to segregating the wire transfer process between Agency employees who initiate, authorize, approve and reconcile the wire transfers within FAD, the Agency also has additional "best practices" and controls in place provided by CBB:

- CBB has provided the Agency's FAD Financial Analysts, responsible for entering transactions, with individual key FOBs that generate a code used to verify the identity of the employee initiating the transaction from IEUA. This is a recommended access control for e-transactions.
- Wire transfers are issued with "Positive Pay with Payee Match". This means CBB compares the information on the wire transfer request with information about the payee, which was provided by the Agency when initially setting-up the payee. This information includes name, address, bank routing number and bank account number. The transaction is only processed by CBB if the information on the transaction matches the information initially provided by the Agency. If any of the information does not match, an exception report is generated and communicated to the Agency.
- CBB also performs call-back to IEUA for wire transfer requests that exceed \$11 million in one day. This means that CBB will call and verify by phone that IEUA requested a wire transfer of \$11 million or more. According to the Agency's CBB banking representative this threshold is determined by the banking client.

Internal Audit notes that these controls are "best practices" and notes that they are good controls to have in place.

Fraud Funds Transfer Insurance Coverage

In addition to the segregation of functions documented above, the Agency has purchased a Fraud Funds Transfer Insurance policy with a limit of \$2,000,000 per occurrence. Therefore, if the Agency can provide information to substantiate that a wire transfer was fraudulent the Agency could recover up to \$2,000,000 less a small deductible for losses incurred. The recovery is limited to the \$2 million and if the fraud were a higher amount, the Agency's recovery would be limited to the \$2 million. This indicates that the Agency is willing to accept the risk for amounts above this limit. Recent media reports of examples of fraud have however, exceeded that limit.

Observation #3: The Agency has a Fraud Transfer Insurance policy limit of \$2,000,000. The Agency should consider increasing the limit to have a higher coverage.

There have been multiple recent examples of frauds perpetrated against governmental agencies that exceeded \$2,000,000. The City of Placentia recently lost over \$5 million through an embezzlement scheme that took place over about two years. The City's insurance policy was \$1 million and the city recovered that amount from insurance. A powerline-undergrounding fraud at the City of Pasadena, although not related to wire transfers, totaled \$6.4 million and occurred over a 10-year period (Pasadena had \$5 million in insurance).

Additionally, CBB does not initiate a call-back to the Agency for transactions less than \$11 million. During the 18-month period reviewed by IA, wire transfer transactions of \$2 million or more included two investment transfers, CalPers payments, MWD invoices and the large bond payment. There were 27 transactions in this category totaling approximately \$147 million, only three of which exceeded \$11 million. IA spoke with the Agency's CBB banking representative who indicated that the call-back threshold is Agency-driven and can be changed at any time. The representative noted that they have clients with a variety of call-back thresholds and that one popular option is at \$5 million per transaction.

It is also IA's understanding that the Agency's cost to obtain higher Fraud Transfer Insurance limits would not be significant.

Recommendation #3:

The Agency should evaluate the cost/benefit of obtaining additional coverage and consider a per occurrence limit greater than \$2 million to ensure the Agency has adequate insurance coverage to address the Agency's risk tolerance. In addition, to address potential uncovered losses, the Agency should consider reducing the threshold for a bank call-back to any amounts that exceed the Agency's chosen limit for Fraud Transfer Insurance.

DEPARTMENT RESPONSE: The Finance and Accounting Department will evaluate the cost/benefit of increasing insurance coverage.

Audit Analysis of Wire Transfer Transactions

To obtain an initial understanding, IA prepared an Internal Control Questionnaire, obtained responses from the Finance department staff and held a kick-off meeting to gather information. Additionally, IA flowcharted the processes and performed a walk-through of the steps in processing each transaction type (wire transfer/EFT and Automated Clearing House).

After confirming the steps in the electronic transactions process, IA decided to focus on wire transfer/EFT transactions and perform an extended walkthrough of transactions to confirm that the documentation in SAP and the Accounting files supports the information obtained:

- Selected approximately 25% of transactions greater than or equal to \$2 million.
- Consider separately the bond repayment of \$51,579,861 as tested during the external audit.
- Selected 10 items less than \$2 million

The “Bond Pay-off” transaction is considered separately. This transaction received significant oversight as part of the bond refinancing steps and additional analysis from the external auditors during their audit procedures. IA, therefore, excluded it from the testing sample, but it is part of total transactions for the period.

Overall, IA tested 41% of the dollars transferred greater than or equal to \$2 million. Including the bond pay-off amount would increase the scrutinized percentage to 56% of dollars transferred greater than or equal to \$2 million.

For amounts less than \$2 million, IA tested 4% of dollar amounts. But, IA also reviewed all transactions for unusual items and noted none.

IA reviewed to ensure:

- Authorization from approved individual (bank account signatory)
- Initiation from authorized individual & verification that appropriate forms submitted and completed
- Approval from a responsible supervisor
- Bank processing in a timely manner

Observation #4: When performing detailed testing of wire transfer transactions, IA noted instances where the SAP documentation was not complete.

Although the Agency maintains printed documentation for wire transfer transactions, that documentation is not always maintained electronically as supporting information in the SAP financial systems. As the Agency continues to automate and upgrade digital recordkeeping, keeping complete documentation in the automated accounting system becomes more important. Without complete automated documentation of transactions in

SAP, the Agency must rely on alternative sources of information and/or manual files that may not be readily available.

Recommendation #4:

FAD should develop standards for documentation of transactions in SAP and a process of reviewing transactions once posted to ensure that the information in the accounting records is consistent and complete.

Investments

In evaluating the general control environment and the use of policies and procedures as part of the Agency's internal controls, IA was informed by FAD that the processes and procedures for investment wire transfer transactions differ from those used with CBB transactions. IA did not test investment transactions as part of this audit. Through the course of performing the described procedures, IA noted two non-recurring transfers during the bond repayment process totaling a combined \$45,000,000. Further review noted that these were investment-related. IA has asked for the documented procedures (SOP's) that guide investment-related transactions. Additionally, IA noted that IEUA recently entered into an agreement with an investment advisor which will impact the investment process. IA recommends wire transfer transactions for investments be audited after the Agency has had sufficient experience with the new investment advisor and the new processes and procedures have been in place for a period of time.

Observation #5: The process for initiating and approving wire transfers for investment-related transactions differs from that used for ordinary banking transactions, is in the process of changing and the new process is not formally documented.

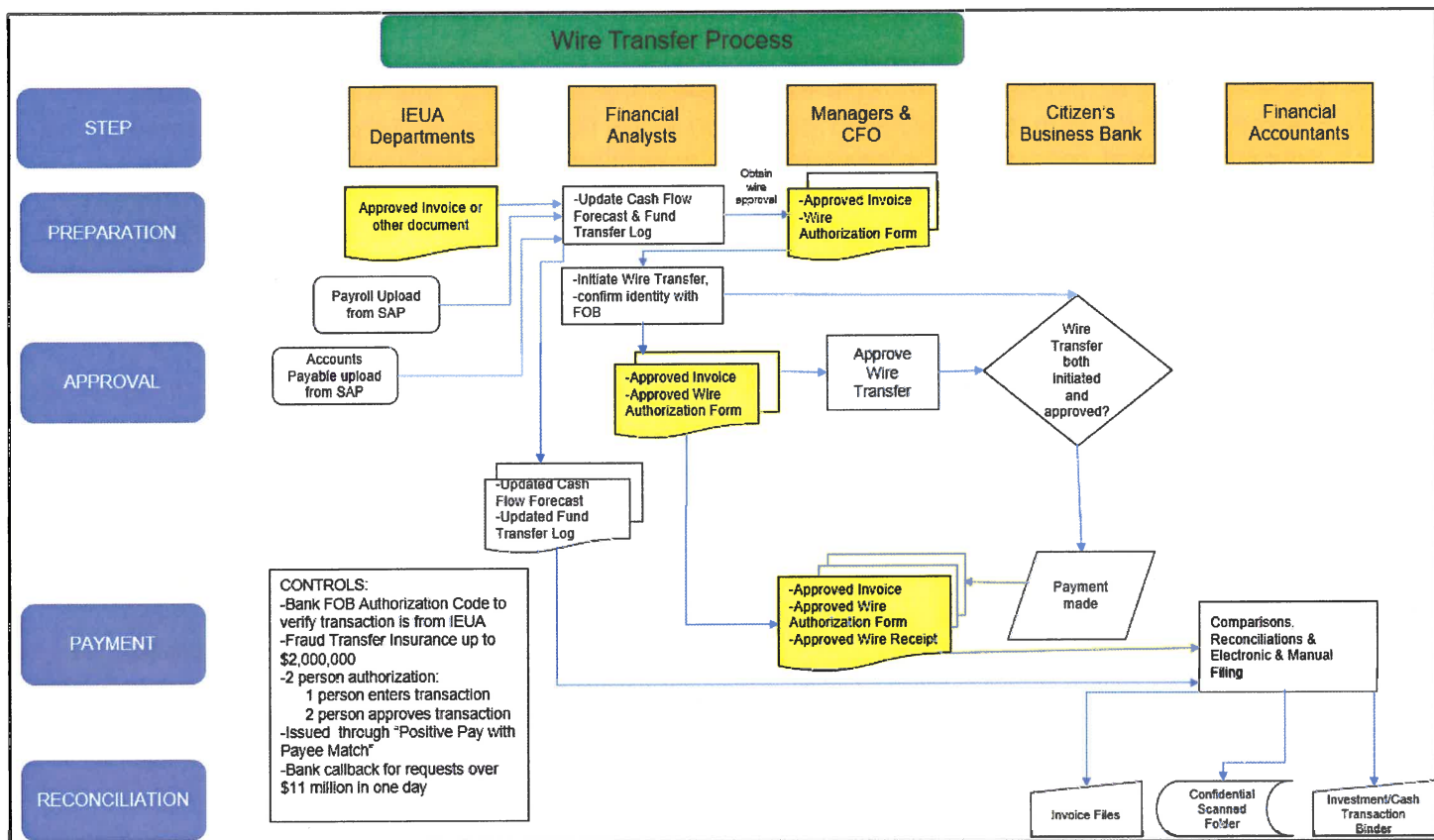
The Agency utilizes a Board-approved Investment Policy to manage its cash resources and has recently entered a new relationship with an investment advisor. This results in wire transfers between investment institutions other than CBB and a different wire transfer process. Without an up-to-date SOP, approved processes are unclear. IA did not test electronic transactions related to investments. As a proactive step, IA provides the recommendation for documenting an up-to-date SOP.

Recommendation #5:

FAD should document or revise a separate SOP that describes the steps in the wire transfer process for investment transactions to provide guidelines for the processing of investment transactions.

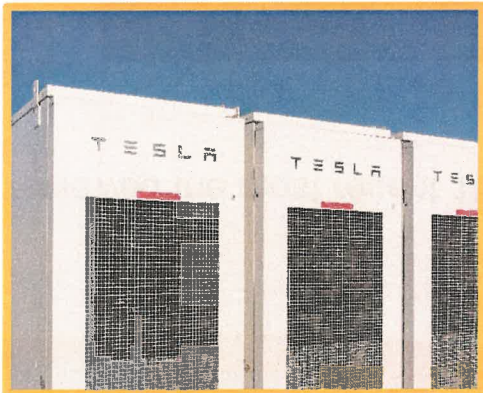
DEPARTMENT RESPONSE: Finance and Accounting disagree with this recommendation. IA explained that IA has a responsibility to comment on matters that came to the Department's attention during the audit and the transactions above came to our attention during the review of electronic disbursements and the general control environment and we would like to provide assurance that documented procedures are available. Please contact IA for additional information.

WIRE TRANSFER PROCESS FLOWCHART



AUDIT COMMITTEE

Wire Transfers Audit



Wire Transfers Audit

IA reviewed the most recent 18 months.

Time-Period	Number of Transfers	Total	Transfers over \$2Million	Average number of transfers per week	Average dollar amount of each transfer
7/1/16 - 12/31/16	126	\$ 103,266,036	10	4.85	\$ 819,572
1/1/17 - 6/30/17	142	\$ 118,165,505	7	5.46	\$ 832,151
7/1/17 - 12/31/17	107	\$ 52,819,729	10	4.12	\$ 493,642*

Internal Controls in Place by Citizen's Business Bank

- Key FOBs that generate a code used to verify the identity of the employee initiating the transaction from IEUA.
- “Positive Pay with Payee Match”. CBB compares the information on the wire transfer request with information about the payee, provided by the Agency.
- CBB performs call-back to IEUA for wire transfer requests that exceed \$11 million.

Internal Controls in Place at IEUA

Segregation of Duties:

- Authorization Form requires two signatures from authorized Agency employees
- Weekly rotation of duties within the Finance Department for Transfer Initiation
- Approval responsibility is limited to the Executive Manager of Finance & Administration/AGM, the Budget Officer and the Manager of Finance and Accounting who must log-in to the CBB portal to execute approval.
- Reconciliation: accounting staff complete the recording and reconciling in SAP and with the bank statement.

Insurance:

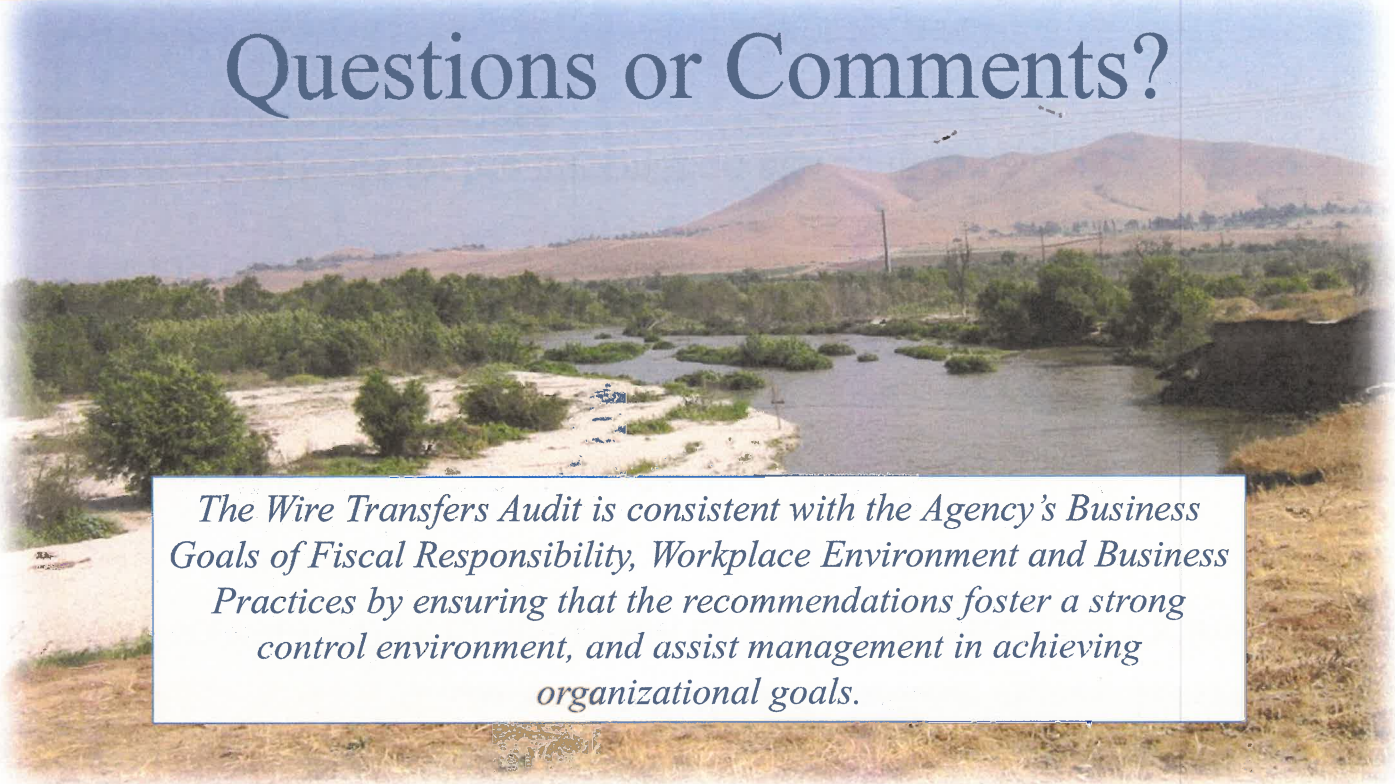
- The Agency has purchased a Fraud Funds Transfer Insurance policy with a limit of \$2,000,000 per occurrence.

Audit Recommendations:

- Update/develop separate SOPs to document electronic transactions for investment transactions
- Electronic signature technology and implementing digital approval documentation
- Finalize wire transfer SOPs
- Consider increasing the Fraud Funds Transfer Insurance policy limit of \$2M per occurrence
- Standardize the requirements for the information stored in the Agency's accounting systems to ensure consistency and completeness



Questions or Comments?



The Wire Transfers Audit is consistent with the Agency's Business Goals of Fiscal Responsibility, Workplace Environment and Business Practices by ensuring that the recommendations foster a strong control environment, and assist management in achieving organizational goals.

Audit Committee

INFORMATION
ITEM
2B

Date: March 21, 2018

To: The Honorable Board of Directors

From: Teresa Velarde, Manager of Internal Audit

Committee: Audit

03/12/18

Subject: Procurement Card Audit

Executive Summary:

Internal Audit (IA) completed an audit of the Agency's Procurement Card (P-Card) program. The audit identified opportunities to further strengthen internal controls to improve the overall effectiveness and efficiency of the P-Card program, including:

- Update Agency Policy A-89 to provide clearer guidelines on the types of purchases allowable or not allowed and provide additional guidance on its use,
- The role of the P-Card Administrator should be enhanced and strengthened to include duties such as reviewing, monitoring and evaluating transactions and the overall program,
- Adopt processes to improve P-Card transaction approvals and reconciliations through the use of on-line tools either through the US Bank's system or the Agency's in-house systems, and
- Consider consolidation of the various credit card programs to take advantage of rebates given in the form of miscellaneous revenue, centralize credit purchases, standardize the processes of approving, reconciling and recording transactions, and enhance visibility and transparency.

Staff's Recommendation:

Receive the Procurement Card Audit report as an information item for the Board of Directors and instruct Agency staff to implement/resolve the audit recommendations.

Budget Impact *Budgeted (Y/N): Y Amendment (Y/N): Y Amount for Requested Approval:*

Account/Project Name:

N/A

Fiscal Impact (explain if not budgeted):

N/A

Full account coding (internal AP purposes only):

- - -
- - -

Project No.:

Prior Board Action:

On March 15, 2017, the Board of Directors reconfirmed the approved Audit Committee and the Internal Audit Department Charters.

On June 21, 2017, the Board of Directors approved the Annual Audit Plan for Fiscal Year 2017/18.

Environmental Determination:

Not Applicable

Business Goal:


The Procurement Card Audit is consistent with the Agency's Business Goals of Fiscal Responsibility, Workplace Environment and Business Practices by having the Internal Audit Department provide an independent evaluation of the P-Card program and provide recommendations for improvements, identify cost containment opportunities, evaluate policy compliance and monitoring the internal control environment of the Agency.

Attachments:

Attachment 1 - Procurement Card Audit report

DATE: March 1, 2018

TO: Halla Razak
General Manager


FROM: Teresa V. Velarde
Manager of Internal Audit

SUBJECT: Procurement Card Audit

Audit Authority

The Inland Empire Utilities Agency (IEUA or Agency) Internal Audit Department (IA) performed an audit of the Procurement Card (P-Card) program. The audit was performed under the authority given by the IEUA Board of Directors and the Fiscal Year 2017/18 Annual Audit Plan. This report provides the results of the audit, along with IA's observations and recommendations.

Audit Objective and Scope

The P-Card Audit objectives were to determine whether P-Card purchases comply with the Agency's Procurement Ordinance Number 101 and Agency Policy A-89 *Procurement Card* Program, assess the adequacy of internal controls in place and to identify improvements for the effectiveness and efficiency of the program.

Audit Techniques:

Audit techniques included:

- Interviews of Agency staff
- Review of Agency policies, procedures, and practices
- Walkthroughs of processes and transactions
- Flowchart of the P-Card process
- Analytical review of P-Card transactions
- Review of supporting documents

Water Smart – Thinking in Terms of Tomorrow

Audit Results – Executive Summary

Section 5.7 of Agency Policy A-89 states: *P-Cards are to be used for purchasing supplies, materials, low-dollar, repetitive, emergency or e-commerce items used for Agency-related business in compliance with the Board-approved Procurement Ordinance.*

The Contracts and Procurement Department (CAP) administers the Agency's P-Card program, which has been an Agency procurement method since 2005. P-Cards work like a credit card and are issued to individual employees. Currently, there are 18 P-Card cardholders. Additionally, there are five other "credit" programs used as a procurement method (discussed later). Cardholders and their supervisors/managers have the responsibility to ensure that all purchases are made for the benefit of the Agency, follow the most appropriate procurement method and ensure transactions are reconciled timely with adequate supporting documentation. The Agency is responsible for the full payment of all purchases made on the P-Cards. The Agency pays US Bank, the credit card issuer, before the due date, with or without a timely reconciliation with the adequate receipts, to avoid late fees, penalties and interest.

The audit identified opportunities to further strengthen internal controls to improve the overall effectiveness and efficiency of the P-Card program.

Details of the observations and recommendations are included in the attached report. The bullet points below provide a summary of audit results:

- **Agency Policy A-89 should be evaluated and updated to provide greater clarity and additional guidance about allowable/un-allowable purchases.** IA's review of P-Card transactions covered a two-year period and found instances of P-Card purchases that, although appear to be for Agency-related expenses, may or may not comply with the guidelines of Agency Policy A-89.
- **The role of the P-Card administrator should be enhanced/strengthened.** The P-Card Administrator's role is established by A-89. The role should include additional duties such as reviewing and monitoring P-Card transactions, communicating with users and supervisors, utilizing online reports and tools from US Bank, making recommendations to enhance the program and participating in training provided by US Bank.
- **Adopting processes to improve P-Card transaction approvals and reconciliations.** According to Policy A-89, reconciliations must be completed with proper supervisory approval within two weeks of receiving the US Bank statement. The audit found that reconciliations are not always completed on time and are sometimes as late as 47 days. The Agency issues full payment to the bank with or without the proper supporting documents and with or without the proper supervisory approvals. The Agency should explore options through SAP or online tools offered by US Bank to streamline the reconciliation and approval process.

- **Consider consolidating Agency credit cards.** The Agency currently uses six different types of credit cards: P-Cards, Travel credit cards, Fuel cards, Home Depot, Smart & Final and Sam's Club. Current Agency policies do not provide sufficient criteria and guidelines over all the different credit cards used. Additionally, there are opportunities to evaluate the benefits of consolidating under the Agency P-Card program. These include, greater visibility for all types of credit-type purchases, online report options, streamlining processes, approvals and reconciliations, and additional earning potential through P-Card rebates. Efficiencies can also be achieved by maximizing business tools available through US Bank for P-Card customers. These include online tools such as supervisor approval, account coding, reconciliation processes, report options and other tools that can make the use of one type of credit card more efficient, centralized and transparent while keeping strong internal controls in place and maximizing rebate earnings.
- **Maximize rebate earnings through consolidating credit programs and early payments.** Rebates are earned based on volume of purchases and the timeliness of payment submitted. By consolidating the various credit cards, the volume rebate can be maximized. By establishing processes that expedite payments, such as electronically receiving the statement and making electronic payments, the timeliness of payment rebate is maximized.
- Additional internal control recommendations are included in this report including recommendations to safeguard gift cards purchased with P-Cards and updating department Standard Operating Procedures (SOPs).

The Procurement Card Audit is consistent with the Agency's Business Goals of Fiscal Responsibility, Workplace Environment and Business Practices by having the Internal Audit Department provide an independent evaluation of the P-Card program and provide recommendations for improvements, identify cost containment opportunities, evaluate policy compliance and monitoring the internal control environment of the Agency.

Acknowledgements

We would like to extend our appreciation to the Contracts and Procurement Department and the Finance and Accounting Departments' staff for their cooperation and assistance during this review.

Discussions with Management

Drafts of this audit report were provided to Christina Valencia, Executive Manager of Finance and Administration/Assistant General Manager and Warren Green, Manager of CAP, on February 16th and to Ms. Valencia, Mr. Green, and Javier Chagoyen-Lazaro, Manager of Finance and Accounting on February 27th for their review and comments prior to finalizing.

Background

The Inland Empire Utilities Agency (IEUA or Agency) established the Procurement Card (P-Card) program with US Bank in November 2005. The purpose of the P-Cards is to allow flexibility in the acquisition of goods in an efficient manner and in accordance with Agency Policy A-89. The Contracts and Procurement Department (CAP) issues the P-Cards to employees, when requested by a department manager, and provides the initial P-Card training.

IEUA participates in the State of California (State), Department of General Services Procurement Division, Cooperative Agreement (Participating Addendum Agreement No. 7-14-99-22, agreement term September 29, 2014 – December 31, 2018) with US Bank for these purchase card services, also known as the Cal-Card Program. The program provides participating agencies with chip-enabled VISA cards, which are used for the acquisition of goods and services. There are no fees associated with this program, including no annual percentage rate (APR) interest on purchases. Organizations participating in this program include: State agencies, Counties, Cities, Special Districts, School Districts, and other public-sector organizations.

The P-Card works like a personal credit card. It is issued in the employee's name to be used for Agency-related purchases. The purpose of the P-Card is to streamline the procurement process for purchases allowed as established under the Board-approved Procurement Ordinance and other purchasing policies that protect the Agency. As of January 31, 2018, there were 18 P-Card cardholders. Spending limits are set for each employee and vary from \$1,500 to \$5,000 for a single transaction and from \$7,500 to \$20,000 for individual monthly limits.

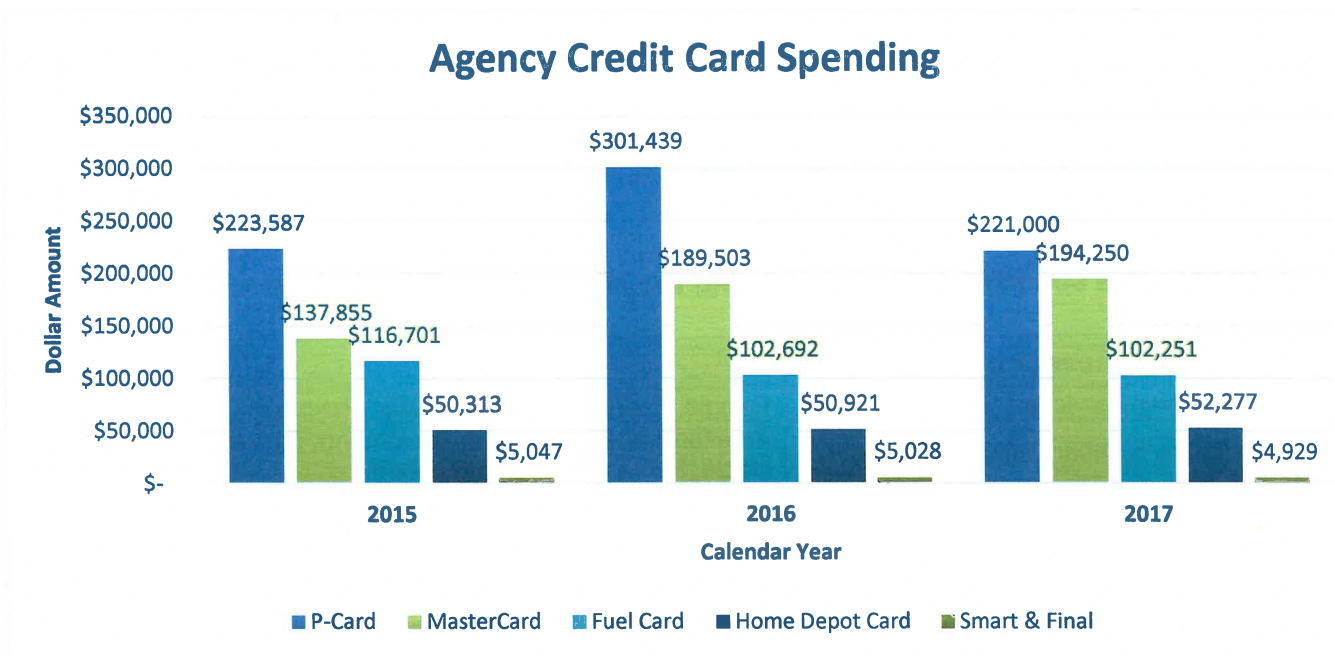
The Agency is responsible for making all payments to US Bank. Payments are made on time so that no fees or penalties are incurred. The P-Card program provides rebates (cash back) to the Agency based on the timeliness of payment and the volume of purchases (more on rebates later in this report).

Agency Credit Cards

This audit focuses on the Agency P-Cards issued through US Bank. IA also performed a limited scope evaluation of other Agency credit card programs. Total Agency spending for the last three calendar years using the various "credit card" programs was:

Credit Card	Vendor	Agency Policy	Number of Cardholders	2015 Spending	2016 Spending	2017 Spending
P-Card (Visa)	US Bank	A-89 January 26, 2016	17-19	\$ 223,587	\$ 301,439	\$ 221,000
Travel Card (Mastercard)	Bank of America	A-55 May 25, 2015	7 -10	138,855	189,503	194,250
Fuel Card	US Bank – Voyager Fleet Systems	A-86 February 4, 2013	177	116,701	102,692	102,251
Home Depot	Home Depot	None	42	50,313	50,921	52,277
Smart & Final	Smart & Final	None	3	5,047	5,028	4,929
Sam’s Club	Sam’s Club	None	1	Not Open	Not Open	No Activity
Totals			Approx. 250	\$ 534,503	\$ 649,583	\$ 574,707

Agency spending among the various Agency credits cards, over the last the three years shown graphically indicates:



Procurement Cards

Total P-Card spending split between IEUA and Inland Empire Regional Composting Authority (IERCA) (information downloaded from SAP) was:

Entity	Calendar Year		
	2015	2016	2017
IEUA	\$ 201,797	\$ 262,860	\$ 208,597
IERCA	21,790	38,579	12,403
Total	\$ 223,587	\$ 301,439	\$ 221,000

(1) = Source: SAP and US Bank P-Card Statements

The review period covers transactions made from January 26, 2016 through December 31, 2017. An analysis of all P-Card transactions, for the 24-month period showed the following distribution among Agency departments by total spending.

Agency Department	Number of Transactions	Total Spending
IEUA		
Contracts and Procurement (CAP)	405	\$ 194,329
Integrated Systems Services (ISS)	674	114,483
External Affairs (EA)	357	110,414
Facilities Management	123	31,882
Human Resources (HR)	54	11,298
Regional Plant #1 – North Maintenance (RP1)	10	4,712
Regional Plant #5 – South Maintenance (RP5)	5	2,789
IERCA	144	50,107
Total	1,772	\$ 520,014

Source: US Bank Access Online system

The top five spending categories, during the 24-month audit period, were as follows:

US Bank Spending Categories	Vendors	Amount
Advertising Services	Google, Facebook, Careerbuilder, Paypal	\$ 80,832
Bookstore & Other Online Purchases	Amazon (mostly computer equipment), Barnes & Noble, Fantastic Snap Photobooth	78,821
Business & Office Services/Purchases	Spirac, Amazon (mostly computer equipment), Win 911 Software/Specter Instruments, EB SAP for Utilities	39,484
Computer Purchases & Online Services	Dell, Microsoft, Hope Industrial Systems, CodeTwo Software Engineering	34,677
Wholesale Industrial Parts & Supplies	Global Industries, BW Allen Company Inc, JCH Inc, Hach Company	24,216

Source: US Bank Access Online – Transaction Detail

Based on the dollars expended, Google was the top vendor used during the two-year audit review period. These were repetitive payments to pay for the advertising campaign for the Water Conservation program called “Kick the Habit”. The second largest vendor used was Amazon, mostly for computer and information technology items/service.

**Top 10 Vendors
 January 1, 2016 – December 31, 2017**

Vendor Name	Description	Number of Transactions	Total Dollar Amount
Google	Advertising Services – Water Conservation advertisements for "Kick the Habit"	156	\$ 77,655
Amazon	Online Purchases – Computer Parts & Accessories (Tablets, Printers, Keyboards, USB Drives, Adapters, Cables, etc.), Cell Phone Accessories, Desk Accessories, Drinking fountain/Bottle filling station, Email Server/Cloud Service, and other supplies	313	65,290
Spirac USA Inc	Industrial Parts & Supplies	2	16,232
Dell	Computer Purchase & Other items	24	12,891
Home Depot	Electric Vehicle Charging Stations	2	6,535
Hope Industrial Systems	Computer & Plant related Equipment	1	6,069
PayPal	Payment Service to Various Vendors, such as JDisc, Alegriafres, Bird Gard, GTBag, etc.	6	6,048
Verizon Wireless	Business Expenses – Data Plan services	14	5,720
Grizzly Coolers	Coolers for Treatment Plants	2	4,887
NTI Global	Industrial Parts & Supplies	1	4,699
Total		521	\$ 206,026

Source: US Bank Access Online – Top Merchant Spend Analysis.

Payment to US Bank

The Agency is required to pay the full monthly balance other than disputed items within 45 calendar days from the billing cycle date. The Agency's P-Card billing cycle generally ends around the 22nd of each calendar month. IEUA pays the monthly balance in full each month, to avoid late fees/penalties, and no balances are carried forward. Payments are often made without all of the completed reconciliations, supporting receipts and supervisor approvals. For 2017, the Agency paid US Bank between 31 and 50 days, and on average within 40 days from the statement date.

Rebates

The State's Cal-Card program pays quarterly "cash back" rebates, which are calculated based on the activity of the three previous months. The two types of rebates the Agency consistently qualifies for are the Volume Sales Incentive which is based on the total volume of purchases made multiplied by the incentive rate (1.3%), and the Prompt Payment Incentive which is based on when the payment is received by US Bank (between 0 and 45 days). The sooner US Bank receives the payment the greater the rebate given. Prompt Payment Incentive Rates range between 0.00% to 0.45%. The rebates are received in a check issued to the Agency and recorded to "Miscellaneous Other Revenue." The table below reflects the rebates received from 2015 to 2017.

IEUA and IERCA

Rebate	2015	2016	2017
Cal Card Rebates	\$2,983	\$3,870	\$5,766

Source: State of California, Department of General Services, Procurement Division website
<http://dgs.ca.gov/pd/programs/CALCard.aspx>

P-Card Process

P-Cards are provided to Agency employees through the following process (**Attachment 1** provides a flowchart of the P-Card process):

- A request is made by a Department Manager to CAP
- CAP issues a P-Card and provides training to the user
- The user signs a P-Card agreement with stated single transaction and monthly limits
- Users make Agency-related purchases
- Users reconcile the purchases receipts to the billing statement, obtain supervisory approval, and submit to Finance and Accounting Department (FAD)
- FAD pays the credit card bill on time (with or without the completed reconciliation to avoid any late payment fees).

Here's what P-Card Users Say:

IA performed a survey about the Agency's P-Cards and five cardholders responded to the 10 questions asked. The purpose was to determine how the Agency's P-Card program is working and how it helps them achieve their job responsibilities. Overall, the users agree that the program provides flexibility to procure items, as needed. Below is a summary of the responses received:

- Cardholders are aware of the Agency's Policy A-89
- Training provided on the P-Card was helpful, but not all questions/concerns were addressed because of the variable purchasing needs
- Cardholders like the P-Card because it is convenient, easy to use, and assists with purchases for urgent/emergency situations
- Purchases on the P-Card allow for meeting quick turnaround times and purchases needed by end-users and the Agency
- Would like to have greater flexibility on the types of allowable purchases
- Cardholders are aware of the special purchase arrangements with certain retailers (Home Depot, Smart & Final, etc.), however, the needs vary and one vendor cannot satisfy all requirements
- Agency Policy needs to be adjusted to complement the current practices
- Current alternatives to the P-Card are antiquated, cumbersome, and do not provide a cost-effective method to procure items
- Cardholders would like online access to review P-Card purchases/charges throughout the month
- Email notifications and/or the P-Card statements were not being received by the Cardholders from US Bank to be able to complete the reconciliation
- Cardholders would like clarification on the P-Card Reconciliation timeline
- Time-period for the P-Card Reconciliation is not long enough

The users indicated a need for either greater flexibility with the program or clarification regarding the Agency Policy.

Observations and Recommendations

The audit identified the several areas that require attention and provide opportunities to improve efficiencies and benefits:

- **Agency Procurement Card Policy:** Updates and revisions to the current P-Card Policy A-89 should be made to ensure current practices are in alignment with Agency goals and requirements, including updating department-specific SOPs. Additionally, the role of the P-Card Administrator should be enhanced. The role should include additional duties such as reviewing and monitoring P-Card transactions, communicating with users and supervisors, utilizing online reports and tools from US Bank, making recommendations to enhance the program and participating in training provided by US Bank.
(Observation #1)
- **Timeliness of the P-Card Reconciliations:** Cardholder reconciliations are not completed according to Policy requirements. Preparing reconciliations ensures timely review of P-Card purchases, supervisory oversight and approvals, and provides for timely processing within the Agency's accounting system (matching to supporting documents, account coding, budget controls, etc.).
(Observation #2)
- **Consolidation of Agency Credit Cards and Rebate potential:** The Agency should consider the benefits of consolidating most Agency Credit cards into the US Bank Procurement Card: 1) to ensure all fall under one Agency Policy, 2) to streamline and consolidate the administration of the programs and 3) to maximize financial incentives to achieve greater monetary rebates.
(Observations #3 & #4)

Agency Procurement Card Policy

Observation 1:

Agency Policy A-89, Procurement Card Program does not reflect current Agency practices, it should be updated to reflect the desired internal controls and guidelines for users.

Good internal controls require written policies and procedures to help ensure that management's directives to mitigate risk and the achievement of Agency objectives are carried out. Additionally, good internal controls provide reasonable assurance of effective and efficient operations, reduce the risk of fraud, waste and errors, and assist in fostering an environment of compliance.

Agency Policy A-89, Procurement Card Program, became effective on January 26, 2016. It sets the guidelines for the use of the P-Cards. IA performed an analytical review of P-Card transactions to determine compliance with the Procurement Ordinance and A-89.

During the 2-year review period since the policy became effective, there were 18-20 P-Cards holders, and approximately 1,700 transactions were processed to procure over \$500,000 in goods/services.

In the same 2-year period an additional \$500,000 in goods/services was purchased with credit on the Bank of America credit card (Travel card), Home Depot and Smart & Final cards which are not covered under Agency Policy A-89. Only the Bank of America (Travel/MasterCard) has a separate Agency Policy, A-55.

The audit determined that, while purchases appear to be for Agency-related business, the current use of the P-Card does not always match the requirements of the current policy, A-89. The policy creates a conflict and may create confusion for users.

Items procured using the P-Card, currently not allowed under Agency Policy A-89
A-89, Section 4.3, defines “**Authorized Purchases**” to include *low-dollar, repetitive, emergency or e-commerce procurements of supplies, services and materials*.

Section 5.7, states that P-Cards are *to be used for purchasing supplies, material, low-dollar, repetitive, emergency or e-commerce items used for Agency-related business in compliance with the Board-approved Procurement Ordinance and not to be used for services unless expressly authorized by the Manager of CFS or designee*.

Section 5.9 states that *the P-Card shall not be used for Agency travel or entertainment expenses*.

Although all purchases made with the P-Card appear to be for Agency business and events, some purchases do not appear to comply with the specific definitions of A-89 or guidelines are absent for such purchases.

**Items purchased with P-Card where Agency Policy A-89 is not clear:
 January 26, 2016 to December 31, 2017**

Types of Purchases	Number of Transactions	Amount	Purpose	Non-compliance Reason:
Advertising	146	\$ 72,654.95	Weekly advertisements for Water Conservation Program	This is considered a service and there was no documented approval. With the volume and amount, an Executed Contract could have been an alternative method if available.
Food & Paperware	59	6,095.81	For various Agency events and meetings	A-89 does not provide specific guidance on expenses for food expenses or events/meetings. It does specify that "entertainment" is not allowed. There are no definitions in either case. There is confusion regarding the allowability of the food items, clarification is needed.
Gift Cards & Raffle Prizes	10	3,402.00	Gift cards for poster contest winners and Disneyland Tickets for Blood drive	A-89 does not provide guidance for awards, gifts, etc. Consideration regarding tax requirements of gifts/awards to employees must be evaluated. Advance notice of events could be handled with an appropriate check request or other payment options, for example a check made to a vendor with a W-9 on file.
Automotive	3	1,057.73	Rental of a bus for Compost Facility tour and car washes	A-89 does not provide guidance for this type of expense. There is an Agency Policy for Vehicle Washes. Advance notice of events could be handled with an appropriate check request or other payment options, for example a check made to a vendor with a W-9 on file.
Memberships	2	797.50	Memberships	A-89 does not provide guidance for memberships; however, these are common Agency expenses paid with an Invoice and/or a Check Request vendor with a W-9 on file.
Total	219	\$84,007.99		

*See Attachment 2 for the list of the transactions in each category.

Advertising

Advertising is considered a "service" and not allowed under A-89 without the express approval of the Manager of CAP. IA did not identify any express authorization.

From January 2016 to June 2017, the External Affairs Department spent approximately \$70K on the P-Card for an advertisement campaign, "Kick the Habit", an Agency Conservation Program. Approximately 145 transactions of \$500 each and 1 transaction of \$154.95 were charged on 3 different P-Cards, all transactions were with the same vendor and for the same type of advertising services. As an alternative to using the P-Card, External Affairs might have worked with CAP to execute an Agency contract with the vendor, stipulating the advertising services, and deliverables, timing, amounts, etc. An Agency contract provides an additional level of protection because it contains the required contract language and clauses, for example liability, insurance, termination, etc. including adding the specific deliverables. Furthermore, payments would have been made with Agency check with the vendor established in Agency's records with a W-9.

Food and Paperware

During the two-year period, the Agency charged approximately \$6,000 on P-Cards for food and paperware for various Agency events such as Earth Day, Agency picnics/luncheon, Outreach programs, Training Lunches/Workshops, Blood Drives, and one employee's business lunch. Agency Policy A-89 specifically disallows "entertainment" expenses; however, it is unclear if "food" is disallowed, as it is not clearly

addressed in the policy. Some food expenses for certain meetings and activities appear to be of a "routine" nature and the policy does allow for "routine" expenditures. Additionally, various events are planned well in advance and therefore, an appropriate check request can be made establishing the vendor in the Agency's records.

It should be noted that similar expenses for "food and paperware" for various Agency-related meetings and events are also charged to the "Travel" MasterCard, which is designated for travel-related expenses and conference registrations. IA did not perform an analysis of those amounts. For management and control of expenditures, it would be appropriate to centralize these purchases using on one type of card consistently. Additionally, clear guidelines and criteria as to when food items are allowed should be provided to prevent misuse or a conflict in policy and practice.

The amounts and the events appear reasonable, however, there is currently no guidance on the parameters, limits or authority for these transactions. IA also noted food purchases through the Smart and Final "credit" program without documentation as to the purpose of the meeting or event. The policy should be clarified to provide clear guidance.

Gift Cards and Raffle Prizes

In the 2-year period reviewed, IA also noted a total of \$3,400 was spent to purchase various gift cards and Disneyland tickets using P-Cards.

Gift cards were purchased from various merchants (Barnes & Noble, Staples, CM School Supply) and for different denominations between \$25 to \$200. The gift cards were for contest programs administered for Water Conservation Programs. Annually, the Agency hosts a poster contest where winners and teachers may earn gift cards as prizes. The gift cards are retained by the department until distributed to the winners.

The amounts spent for Gift Cards was not material or significant. IA did identify two concerns with these items: first, there is no guidance on the allowability of purchasing gift cards since Policy A-89 does not specifically these. Second, there is no guidance for internal controls. Gift cards should be safeguarded like cash, for example, keeping the cards in a locked cash box, and keeping a log with information about who the cards were awarded to, to provide accountability for the gift cards.

Disneyland tickets were purchased as a Raffle prizes to encourage employee participation in the Agency-sponsored blood drive. Amusement park passes and gift cards are not addressed in A-89.

The concern with Disneyland tickets is an IRS guideline that requires employers to tax the value of tickets to the employee that received them as raffle prizes, and include them in taxable income. The Agency should evaluate all aspects of allowing the purchase and raffle of Disneyland tickets as prizes to its employees.

Automotive

In the 24-month review period, IA noted a total of \$1,057 was procured on the P-Card for a vehicle rental and car washes. This vehicle was a very specific rental needed for a “VIP” tour. The car washes were obtained prior to hosting tours of the Agency’s treatment plants and/or composting facility. According to Agency Policy A-34 (Vehicle Maintenance), the Agency has the vehicles routinely washed on site by a contractor, and thus, they should only be washed elsewhere in extenuating circumstances. Since this was a planned event, it was not an emergency and the amount does not appear to be “low dollar” in nature, other procurement methods could have been applied. Policy A-89 should be updated to address these types of Agency needs.

Memberships

IA identified two P-Card transactions for a total of \$797 that were related to memberships. One was a membership to a discount warehouse and the second was for annual renewal of a professional association. Policy A-89 does not provide guidance for the payment of memberships, but in both cases a check written out to a vendor with an appropriate W-9 on file would have been more appropriate. That is what employees are generally asked to do for memberships. This would have then provided a secondary approval prior to the purchase.

Conclusion – Agency Procurement Card Policy

While all purchases appear to be for Agency-related business, the current Agency Policy A-89, does not provide guidance for the noted items. The Agency should explore options for expanding the use of the P-Card and providing clearer guidelines on its use.

2018 Recommendation(s):

- 1. Agency Policy A-89, Procurement Card Program should be updated to reflect desired internal controls and provide clearer guidelines about the proper use of P-Cards. The policy should provide greater clarity about the purchases that are allowed or not allowed (i.e.: food, restaurant meals, training registrations, membership payments, etc.). Additionally, the policy should provide instructions for users to follow when there are situations that are unusual and note the additional written justification that is necessary. Lastly, A-89 should direct users to seek CAP’s guidance when there is a unique need, keeping the Agency’s needs in mind and ensuring adequate controls are maintained.***

The Role of the P-Card Administrator

According to the Agency Policy A-89, the P-Card Administrator’s duties include:

- Section 4.5 states that the P-Card Administrator is a designated staff member from the Contracts and Facilities Department authorized to facilitate the P-Card Program, and***
- Section 6.3 states that the P-Card Administrator is responsible for the overall administration of P-Cards, the issuance and training of the P-Card Program.***

The audit noted that the P-Card Administrator role is a staff member from CAP and performs the duties of issuing cards and providing training. The recommendation is to enhance the role of the P-Card Administrator to include additional duties of oversight, monitoring of transactions (or spot checks to look for unusual items) and requesting additional information as warranted. Additionally, the P-Card Administrator could utilize the various online reporting tools available through US Bank *Access Online* to access reports and information useful to analyze spending activity, types of vendors used, limits, lack of use, etc. The online tools can also provide alerts based on specific setting requirements, such as when a card is used on the weekend, a purchase is over a certain dollar threshold, or by types of purchases. US Bank provides many online tools and free webinars about their tools to inform users and administrators about the various products and opportunities to manage and monitor cards. The P-Card Administrator should also be responsible for continuous training for users.

There is also confusion about who is responsible for the collection of P-Cards from employees that separate from Agency service. Currently, the employee separation process resides with Human Resources. Agency Policy A-89 does not define how P-Cards will be retrieved from separated employees. It states that the Cardholder is responsible for returning the P-Card at the request of the Department Manager, the P-Card Administrator, or Division Management. The P-Card administrator should have a level of responsibility for collecting the cards and completing the required forms. In one instance tested, through our audit, there was not adequate documentation that a card was returned and forms completed when an employee separated from Agency service. The risk of not having a designated individual responsible for collecting the card, is that an employee that leaves Agency service may continue to use the card. Therefore, adequate communication should be in place to ensure the Administrator can block access to the card immediately upon separation.

IA recommends that the P-Card Administrator role be enhanced with greater oversight duties to monitor P-Card activities, as well as use the various online reporting and alert tools. Expanding the P-Card Administrator's role, will also enhance the monitoring of P-Card transactions to identify any non-compliance or opportunities to assist the various users to ensure the best procurement option is employed.

2018 Recommendation(s):

- 2. The P-Card Administrator role should be clarified in Policy A-89 and expanded to include greater oversight responsibilities to ensure compliance. The role should include duties to fully utilize the various on-line tools available through US Bank for reports, alerts, training and other controls for reviewing and monitoring activity. Additionally, the P-Card Administrator should provide assistance and give advice on the best procurement method and periodically review statements and identify purchases and transactions that are not aligned with policy and request additional information.***

Standard Operating Procedure (SOP)

Agency Policy A-51 (Standard Operating Procedures, effective November 11, 2013) provides the *guidelines* and *format* to be utilized for documenting SOPs. CAP has a specific SOP related to P-Cards; CAP-0012 – Procurement Cards, Version Number 001, and Version Date August 15, 2013. In this SOP, the process, procedures and content were last updated in 2013, and since that time, the P-Card program has grown and evolved. Additionally, the Agency-wide Policy A-89 was updated in 2016.

Good internal controls require written procedures to ensure consistency and accuracy in applying procedure. SOPs serve as a training tool and manual for other staff. Policies and procedures should be reviewed periodically to ensure they are updated and consistent with current practice. Department SOPs are part of the Agency's internal control framework.

2018 Recommendation(s):

- CAP should update Department-specific SOP CAP-0012 to incorporate any changes in Agency Policy A-89 Procurement Card Program, including any updates to the P-Card Administrator's role and responsibilities. Additionally, CAP should ensure the SOP CAP-0012 complies with the guidelines and format set forth in Agency Policy A-51.***

Timeliness of Approvals and Reconciliation

Prior to IA's review of the P-Card program, IEUA's Lean Team evaluated the P-card processing system for efficiency. Due to the Lean Team's review 1) cardholders now receive their US Bank P-Card statements sooner than before (from approximately 19 days to 1 day), 2) the reconciliation form for users was standardized, and 3) Agency Policy A-89 Procurement Card was adopted.

IA's review was to determine compliance with the criteria and timeline requirements established within A-89 and evaluate transactions after the date of the policy adoption.

Observation 2:

Individual P-Card reconciliations are not being completed and approved by the timeline established in Agency Policy A-89.

According to Policy A-89, within *1 week* of receipt of the P-Card statement notification (by email), the Cardholder must download and print their statement, reconcile all purchases made during the billing cycle, record the information on the P-Card Purchase Log Upload file, sign it, and scan the backup supporting receipts/documents. Once the information has been compiled, the Cardholder submits the P-Card reconciliation and any supporting documentation to the designated approver for review and approval. The designated approver has *1 week* to review, approve and sign-off on the reconciliation and back up

documents. After approval has been obtained, all hardcopy supporting documentation is forwarded to FAD for upload to SAP, the Agency's accounting system.

IA evaluated the two most recent months of statements for compliance with the time requirements as stated in the policy:

Analysis of P-Card Reconciliations	November 2017	December 2017
Total # of Cardholders with purchases during this month	12	10
Total # of days it took cardholders to complete reconciliation	5 to 62 days, Average 17 days	5 to 31 days, Average 16 days
Total # of days it took approvers to review and sign the P-Card Purchase Log after user completed the reconciliation	0 to 12 days, Average 4 days	0 to 15 days, Average 5 days
Total # of reconciliations completed and approved on time (within the 2 weeks as required by A-89)	3 of 12 only 25%	1 of 10 only 10%
Total # of reconciliations completed late, but before the Agency paid the US Bank Statement	6 of 12 only 50%	5 of 10 only 50%
Reconciliations completed after the Agency paid US Bank	1	0
Total # of reconciliations not completed as of January 25, 2018 (approximately 30 and 60 days after the cardholder statement is available to users)	2 of 12 17%	4 of 10 40%

Based on IA's review:

- **Reconciliations (P-Card Purchase Log file) are not always completed within 1 week as required by A-89;** In the 2 months tested, reconciliations were completed in 5 to 62 days and on average in 17 days.
- Of the reconciliations completed, **reconciliations are not always approved by supervisors within 2 weeks of the statement date as required by A-89.** Either the cardholder does not complete their reconciliation on time or the supervisor doesn't provide the approval on time.
- Of the reconciliations completed, IA noted they are not always signed by the cardholder and/or approver.
- Two cardholders are at the managerial level and do not obtain a higher-level signature on the reconciliation. **A-89 does not provide criteria for management employees having to obtain approval for P-Card purchases but it does state that a "designated approver" shall review and verify purchases.**

- US Bank P-Card Statements are not always signed by the Cardholder and/or Approver. IA noted that of completed reconciliations, in November only 2 and in December only 1 cardholder statement was signed. Agency Policy A-89 does not specifically require signature on the US Bank Statement, however, the statement has a line item for signature and the following language “*We certify that all purchases listed on this statement, unless annotated to the contrary, are true, correct and for official business only. Payment is authorized.*” The Agency should consider specifying in the policy if this is a requirement so that there is consistency in the approval process.
- Of the reconciliations reviewed, IA noted that for one month, one user did not include supporting receipts/documentation as required by A-89.
- Noted several instances when P-Card reconciliations were completed, after the Agency had paid for the P-Card purchases.

Reconciliations that are not completed on-time effect when the P-Card transactions are posted into the Agency’s financial system (SAP). Currently P-Card purchases are posted to a Clearing account and remain in this account until ready to be posted to the designated General Ledger (G/L) account as noted on the reconciliation. In addition, FAD has a batch processing system in place to upload P-Card purchases, which means the transactions are gathered and uploaded at one time, rather than as each purchase occurs. The longer Cardholders take to complete the reconciliation, the longer FAD waits to upload the P-Card transactions into SAP. This impacts the timing of posting the transactions and the availability of budgeted funds.

Any errors made in the reconciliation (account numbers, etc) slow down the posting and processing and must be addressed. This increases the amount of time required to post P-Card purchases to GL accounts.

Without timely supervisory review, timely reconciliations and posting to Agency’s financial system, unusual transactions and items can go undetected and can leave the Agency vulnerable to misuse and errors. *The CAP and FAD departments should communicate to designated approvers and cardholders the importance of the timeliness of the P-Card reconciliation and review of monthly transactions.*

IA consulted with US Bank to determine if online tools are available to expedite the P-Card reconciliation process. According to US Bank, several features are available as part of their system that could automate and streamline the supervisor approval and the reconciliation processes to make more it efficient, including online account allocation, electronic routing of approval, and electronic reporting available to upload P-Card transactions into SAP. Additionally, US Bank offers online training for cardholders and administrators on the various tools available.

2018 Recommendations:

- 4. CAP and FAD should work together to utilize any in-house tools and/or on-line tools available through US Bank to make the review, approval, reconciliation and upload of P-Card purchases more efficient with adequate oversight.***

Consolidation of Agency's Credit Cards

Observation 3:

The Agency has different types of credit cards, not all of which are covered by an Agency policy, and do not have the same type of supervisory review, oversight and administration requirements. There are opportunities to maximize the rebate paid to the Agency by consolidating most credit card programs under the P-Card issued through US Bank while also improving efficiency and oversight.

To fulfill the procurement needs of the organization, the Agency has implemented various Credit Card programs to conduct Agency business and make necessary purchases. Currently, IEUA has 6 types of Credit Cards that provide multiple ways to procure the Agency's needs. Approximately \$600,000 is procured annually using these various credit card programs through about 250 cards issued to Agency employees.

IA noted concerns with having multiple credit card programs:

- Decentralization & policy application:** Currently, the administration of the Agency credit cards is decentralized and handled through various departments such as Executive Administration, CAP and Operations. Only 3 of the 6 Credit Cards types are subject to a relevant Agency Policy that specifies what is or is not allowed. Not all credit cards require the same reconciliations and approvals.
- Vendor-specific "credit" program & PR/PO process:** Home Depot and Smart & Final are based on a Blanket Purchase Agreement, which is an open account to purchase items, where items are purchased and the bill is sent to the Agency later. Purchases on Home Depot and Smart & Final cards are accounted for and reconciled through the SAP workflow process using the Agency's Purchase Requisition (PR)/Purchase Order (PO) system. The use of the PR/PO system results in automatic entry of the expense into the financial records, making the accounting process smoother for FAD. However, issuing a PR/PO after the purchases are made and items are acquired, is inconsistent with the intent of the PR/PO process, which should be initiated before the purchases are made. Having employees use a P-Card instead would be consistent with actual, current practice.
- Administration of credit card expenses with on-line tools and reports:** Having different credit card programs does not provide for efficient administration of all purchases. For example, with the US Bank P-Card, administrators have

access to various on-line report tools to sort, review, evaluate and analyze credit card activity. This facilitates and improves the visibility and transparency of expenses. Additionally, it will standardize the procurement, approval and reconciliation processes. Lastly, US Bank, provides various on-line tools to monitor use and create alert notices, and automate the purchases approval process on a transaction level, rather than waiting until the end of the month.

The Agency should consider consolidation of cards into one Agency Credit Card Program, other than the Voyager Fuel Card, all governed under one Agency Policy (keeping the Voyager Fuel card separate provides other benefits such as recording vehicle odometer readings and restrictions on food purchases).

2018 Recommendation(s):

- 5. CAP should take the lead to evaluate the benefits of consolidating credit card programs to utilize P-Cards for all purchases (other than fuel) and to eliminate other vendor-specific credit cards or credit programs. At a minimum, the Agency should ensure all Credit Card programs are governed by an approved Agency policy.***
- 6. CAP should maximize the use of the US Bank online tools for downloading/reviewing reports, creating blocks and alert notices for unusual activity, streamlining the approval, reconciliation and upload/posting process and training end users and approvers.***

Rebates

Observation #4: IA noted there are opportunities for the Agency to achieve greater financial benefits in the form of cash-back revenue.

As part of the State's Cal-Card (P-Card) program, each Participating Agency is eligible to receive rebates. The types of rebates available and the terms and conditions are outlined in the agreement. The Agency receives rebates from US Bank for the Volume Sales Incentive. Another rebate is received for Prompt Payment, but the amount is minimal compared to Volume Sales Incentive.

The Agency currently pays the US Bank P-Card statement with a Vendor Check close to the 45-day term, which is the required due date per the agreement. During our review, payments were made between 31 and 50 days from the date of the Statement for calendar year 2017 (see attachment 4). The payment date may be determined based on the date of the weekly/monthly check runs. There does not seem to be a reason why payment should not be made immediately upon receiving the bill since the Agency pays the bill whether or not the cardholder reconciliations are completed and approved.

The bill can be downloaded on-line or received electronically from US Bank to expedite receipt and review of the bill. The Agency also has the option to pay the bill using ACH or other e-payable system, to expedite the payment and maximize the rebate.

IA recalculated the potential rebate that could have been earned using two scenarios: 1) if credit cards other than the Voyager Fuel Card had been consolidated and 2) if payment was made within the first 15 or 30 days from the statement date, see below:

Credit Card	2015 Total Spending	2016 Total Spending	2017 Total Spending
US Bank P-Card (Visa)	\$ 223,587	\$ 301,439	\$ 221,000
Bank of America Travel Card (Mastercard)	138,855	189,503	194,250
Home Depot	50,313	50,921	52,277
Smart & Final	5,047	5,028	4,929
Total Spending of all Cards	\$417,802	\$546,891	\$472,456
Total Rebates Received based on P-Card Only	\$2,983	\$3,870	\$5,766

Potential Rebates

Scenario # 1 – Payment received 30th day

If all “credit” purchases had been procured using the P-Card and payment to US Bank was made on the 30th date from the date of the statement:

Type of Rebate	2015 Rebate Amount	2016 Rebate Amount	2017 Rebate Amount
Volume Rebate 1.3%	\$5,431	\$7,110	\$6,142
Prompt Payment Rebate 0.30% ⁽¹⁾ (assuming payment is received by US Bank on the 30 th day from the Statement Date)	1,253	1,641	1,417
Total – Potential Rebate based on all Cards	\$6,684	\$8,750	\$7,559

(1) = Attachment 3 has the table with the rates for the Prompt Payment Incentive rates. Note: Calculation is technical, for additional information, contact Internal Audit Department.

Scenario # 2 – Payment received 15th day

If all “credit” purchases had been procured using the P-Card and payment to US Bank was made on the 15th day of the date of the statement:

Type of Rebate	2015 Rebate Amount	2016 Rebate Amount	2017 Rebate Amount
Volume Rebate 1.3%	\$5,431	\$7,110	\$6,142
Prompt Payment Rebate 0.450% ⁽¹⁾ (assuming payment is received by US Bank on the 15 th day from the Statement Date)	1,880	2,461	2,126
Total – Potential Rebate based on all Cards	\$7,311	\$9,571	\$8,268

(1) Attachment 3 has the table with the rates for the Prompt Payment Incentive rates. Note: Calculation is technical, for additional information, contact Internal Audit Department.

Rebates actually received based on P-Card Purchases (payment was made between 24 & 54 days of the Statement Date)	\$2,983	\$3,870	\$5,776
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US Bank also offers other opportunities to maximize rebates earned, such as paying other types of payables/bills through the P-Card. *CAP and FAD should research/evaluate any other programs that could earn additional rebates for the Agency.*

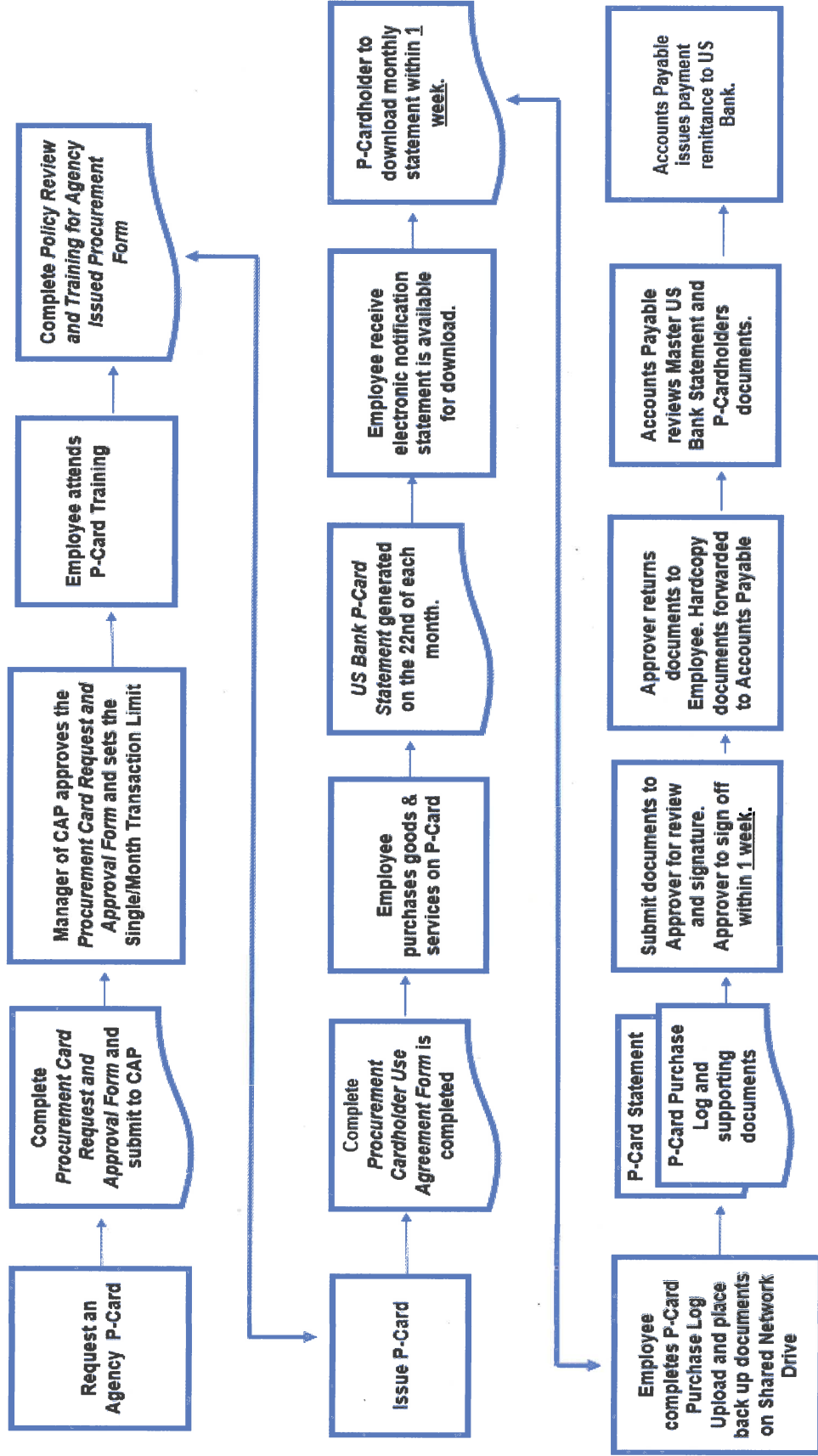
2018 Recommendation(s):

- FAD should evaluate ways for the Agency to increase and/or maximize any rebates received.***

Please contact the Internal Audit Department for additional information related to the analysis' in this report.

Attachment 1 – Procurement Card Process Overview

Source: Agency Policy A-89



**Attachment 2 – Table of Exceptions
 P-Card Purchases Not Within Policy Requirements
 January 26, 2016 to December 31, 2017**

Advertising:				
Transaction Date (Date Range)	Description	Vendor	Amount	Exception
January 28, 2016 to June 9, 2017	Advertising Services – Ad Campaign (Re-occurring charge every 2 to 3 days at \$500-dollar increments, 145 times and 1 time at \$154.95)	Google	\$ 72,654.95	Not Low dollar purchase

Automotive:				
Transaction Date	Description	Vendor	Amount	Exception
May 5, 2017	Bus for 10-year celebration/ Composting Facility Tour (Vehicle Rental)	Cardiff Limousine	\$ 1,023.75	Not materials or supplies
May 5, 2017	Car Wash for VIP Tour	Chino Hills Car Wash	15.99	Not materials or supplies
December 1, 2017	Car Wash for Agency Van for VIP Tour	Chino Hills Car Wash	17.99	Not materials or supplies
Total Automotive			\$ 1,057.73	

Disneyland Tickets:				
Transaction Date	Description	Vendor	Amount	Exception
March 23, 2016	Disneyland Tickets for Blood Drive	Disneyland	\$ 195.00	Entertainment
August 31, 2016	Disneyland Tickets for Blood Drive	Disneyland	215.00	Entertainment
January 12, 2017	Disneyland Tickets for Blood Drive	Disneyland	238.00	Entertainment
April 13, 2017	Disneyland Tickets for Blood Drive	Disneyland	248.00	Entertainment
July 7, 2017	Disneyland Tickets for Blood Drive	Disneyland	248.00	Entertainment
October 25, 2017	Disneyland Tickets for Blood Drive	Disneyland	248.00	Entertainment
Total Disneyland Tickets			\$ 1,392.00	

Gift Cards:				
Transaction Date	Description	Vendor	Amount	Exception
April 4, 2016	Purchase of Gift Cards for "Water is Life" Poster Contest Winners (3 @ \$25, 3 @ \$35, and 3 @ \$50)	Barnes & Nobles Booksellers	\$ 330.00	Gift Cards
April 4, 2016	Purchase of Gift Cards for "Water is Life" Teacher Winners (6 @ \$50 each, 1 @ \$150 each)	CM School Supply	450.00	Gift Cards
April 27, 2016	Purchase of Gift Cards for "Water is Life" Poster Contest Winners (3 @ \$25, 3 @ \$35, and 3 @ \$50)	Barnes & Nobles Booksellers	330.00	Gift Cards
April 27, 2017	Purchase of Gift Cards for "Water is Life" Poster Contest Teacher Appreciation (5 @ \$100 each, 2 @ \$200 each)	Staples	900.00	Gift Cards
Total Gift Cards			\$2,010.00	

Attachment 2 – Table of Exceptions (Continued)

Food & Paperware:				
Transaction Date	Description	Vendor	Amount	Exception
July 19, 2017	Ice for Employee Recognition Picnic	7-Eleven	\$ 49.05	Food Expense
March 24, 2016	Grocery Store – Refreshments for Poster Contest Judging	Albertsons	16.98	Food Expense
April 13, 2016	Grocery Store – Water is Life Pizza Party (Junior High School)	Albertsons	8.97	Food Expense
April 20, 2016	Grocery Store – Ice for Earth Day event	Albertsons	38.82	Food Expense
May 3, 2016	Grocery Store – Water is Life Pizza Party (Elementary School)	Albertsons	7.00	Food Expense
May 11, 2016	Grocery Store – Receipt Lost	Albertsons	10.00	Food Expense
May 18, 2016	Grocery Store – Earth Day Volunteer Luncheon – Sodas/Juice	Albertsons	14.33	Food Expense
May 23, 2016	Grocery Store - Water is Life Pizza Party (Elementary School)	Albertsons	21.98	Food Expense
July 20, 2016	Grocery Store – Ice for Agency Picnic	Albertsons	51.75	Food Expense
July 20, 2016	Grocery Store - Ice for Agency Picnic	Albertsons	51.75	Food Expense
October 20, 2016	Grocery Store – Ice for Dedication Battery Project event	Albertsons	12.94	Food Expense
February 24, 2017	Grocery Store – Water Discovery Program – Supplies	Albertsons	29.46	Food Expense
April 5, 2017	Grocery Store – Water is Life Judging Treats	Albertsons	23.16	Food Expense
April 19, 2017	Grocery Store – Ice for Earth Day event	Albertsons	45.18	Food Expense
July 10, 2017	Grocery Store - Edible Aquifer Activity Food Supplies	Albertsons	16.90	Food Expense
July 25, 2017	Grocery Store – Soda for Training Meeting	Albertsons	22.27	Food Expense
August 23, 2017	Grocery Store – Edible Aquifer Activity Food Supplies	Albertsons	24.56	Food Expense
October 31, 2017	Grocery Store - Edible Aquifer Activity Food Supplies	Albertsons	42.51	Food Expense
November 30, 2017	Grocery Store - Employee Appreciation Treats for tree decorating on 12/5/17	Albertsons	17.17	Food Expense
December 4, 2017	Grocery Store - Gloves for Handling Cookies & Pretzels	Albertsons	5.38	Food Expense
December 18, 2017	Grocery Store - Holiday Luncheon Cookies	Albertsons	475.00	Food Expense
January 25, 2017	Food Purchase - Training Lunch	Corner Bakery	347.89	Food Expense
March 2, 2017	Food Purchase – Project Wet Workshop	Corner Bakery	387.80	Food Expense
July 27, 2017	Food Purchase – Training Lunch	Corner Bakery	209.00	Food Expense
August 22, 2017	Food Purchase – Food for Operations & Maintenance Management Training	Corner Bakery	167.20	Food Expense
May 4, 2016	Food Purchase - Water is Life Pizza Party (Elementary School)	Domino's Pizza	78.72	Food Expense
May 12, 2016	Food Purchase - Water is Life Pizza Party (Elementary School)	Domino's Pizza	76.72	Food Expense
May 24, 2016	Food Purchase - Water is Life Pizza Party (Elementary School)	Domino's Pizza	145.86	Food Expense
January 23, 2017	Food Purchase – Lunch for Interview Panel	Las Cascadas	66.32	Food Expense
December 15, 2017	Holiday Luncheon Game Prize	Logan's Candies	85.00	Food Expense
January 25, 2017	Food Purchase – Training Lunch	Panera Bread	124.90	Food Expense
January 26, 2017	Food Purchase – Training Lunch	Panera Bread	289.13	Food Expense

Procurement Card Audit
 March 1, 2018
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January 26, 2017	Food Purchase – Training Lunch	Panera Bread	119.90	Food Expense
March 2, 2017	Food Purchase – Project Wet Workshop	Panera Bread	162.19	Food Expense
May 18, 2016	Supplies for Earth Day Volunteer Recognition Luncheon - Paperware	Party City	105.59	Paperware Expense
December 4, 2017	Gourmet Applies for Employee Holiday Lunch – Game Prize	QVC	44.20	Food Expense
July 10, 2017	Food Purchase - Edible Aquifer Activity Food Supplies	Ralphs	4.99	Food Expense
May 18, 2016	Supplies for Earth Day Volunteer Recognition Luncheon	Sam's Club	37.96	Food Expense
July 13, 2016	Picnic Supplies for Employee Picnic – Drinks and Paperware	Sam's Club	377.36	Food/Paperware Expense
April 3, 2017	Earth Day Supplies – Snacks and Drinks	Sam's Club	211.23	Food Expense
July 5, 2017	Board Meeting - Snacks	Sam's Club	43.28	Food Expense
July 12, 2017	Supplies for the Employee Appreciation Picnic Paperware Goods	Sam's Club	616.43	Paperware Items
July 17, 2017	Supplies for the Employee Appreciation Picnic Water and Soft Drinks	Sam's Club	213.95	Food Expense
September 18, 2017	Purchase of Paperware for Engineering Pizza Party	Sam's Club	34.61	Food Expense
September 21, 2017	Food Purchase – Pizza – Engineering Pizza Party	Sam's Club	106.55	Food Expense
September 21, 2017	Food Purchase – Pizza – Engineering Pizza Party	Sam's Club	19.98	Food Expense
May 9, 2016	Edible Aquifer Activity Supplies	Smart and Final	56.72	Food Expense
January 10, 2017	Candy for Blood Drive Give away	Smart and Final	48.96	Food Expense
February 24, 2017	Edible Aquifer Activity Supplies	Smart and Final	46.32	Food Expense
April 11, 2017	Candy & Other Snacks for Blood Drive Give away	Smart and Final	36.96	Food Expense
April 12, 2017	Candy & Other Snacks for Blood Drive Give away	Smart and Final	(2.99)	Food Expense
July 11, 2017	Candy for Blood Drive Give away	Smart and Final	37.98	Food Expense
October 23, 2017	Candy for Blood Drive Give away	Smart and Final	30.98	Food Expense
January 16, 2017	Grocery Store – Edible Aquifer Activity Food Supplies	Stater Brothers	41.74	Food Expense
February 14, 2017	Food Purchase - Edible Aquifer Activity Food Supplies	Stater Brothers	21.33	Food Expense
April 12, 2016	Earth Day Supplies – Purchase includes Water, Drinks, Snacks, and other supplies	Walmart	408.66	Food/Paperware Expense
July 19, 2016	Picnic Supplies for Employee Picnic – Water, Drinks, Food, Paperware	Walmart	34.07	Food/Paperware Expense
July 19, 2016	Picnic Supplies for Employee Picnic – Water, Drinks, Food, Paperware	Walmart	142.51	Food/Paperware Expense
April 17, 2017	Earth Day Supplies – Purchase includes Water, Drinks, and Supplies	Walmart	130.65	Food/Paperware Expense
Total Food & Paperware			\$ 6,095.81	

Membership:

Transaction Date (Date Range)	Description	Vendor	Amount	Exception
June 29, 2017	Sam's Club Membership Renewal	Sam's Club	\$ 90.00	Duplicate Membership
August 23, 2017	US Composting Council Renewal	US Composting Council	707.50	Not addressed in Agency Policy A-89
Total Memberships			\$797.50	

**Attachment 3 –
 Prompt Payment Incentive**

Days held	Speed of Pay Rate
0	0.450%
1	0.440%
2	0.430%
3	0.420%
4	0.410%
5	0.400%
6	0.390%
7	0.380%
8	0.370%
9	0.360%
10	0.350%
11	0.340%
12	0.330%
13	0.320%
14	0.310%
15	0.300%
16	0.290%
17	0.280%
18	0.270%
19	0.260%
20	0.250%
21	0.240%
22	0.230%
23	0.220%
24	0.210%
25	0.200%
26	0.190%
27	0.180%
28	0.170%
29	0.160%
30	0.150%
31	0.140%
32	0.130%
33	0.120%
34	0.110%
35	0.100%
36	0.090%
37	0.080%
38	0.070%
39	0.060%
40	0.050%
41	0.040%
42	0.030%
43	0.020%
44	0.010%
45	0.000%

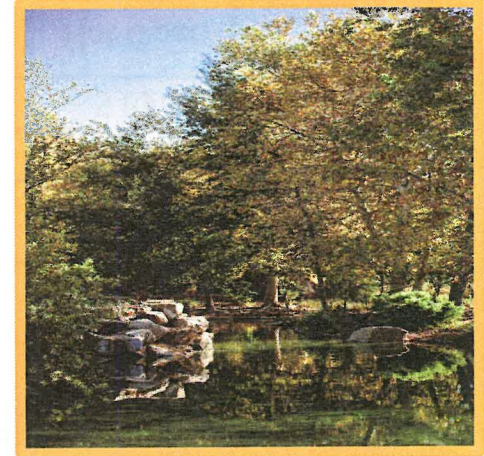
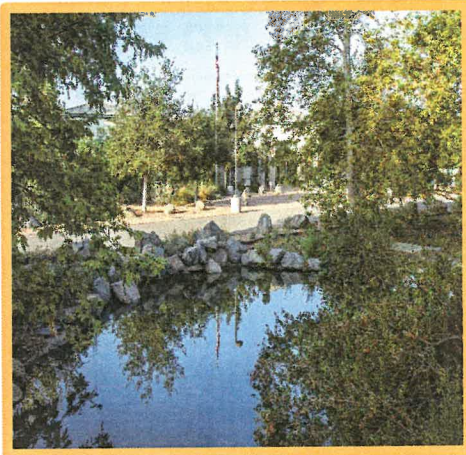
Attachment 4 – Payment Dates to US Bank

IEUA Only

Year	Statement Date	Date Paid by Agency	Number of Days taken to pay US Bank P-Card Statement
2015	January 22, 2015	March 6, 2015	46
	February 23, 2015	April 9, 2015	46
	March 23, 2015	May 7, 2015	45
	April 22, 2015	June 15, 2015	54
	May 22, 2015	July 2, 2015	41
	June 22, 2015	July 16, 2015	24
	July 22, 2015	August 20, 2015	29
	August 24, 2015	September 28, 2015	35
	September 23, 2015	October 29, 2015	37
	October 23, 2015	December 7, 2015	46
	November 23, 2015	December 23, 2015	30
	December 22, 2015	February 11, 2016	51
2016	January 22, 2016	March 8, 2016	46
	February 22, 2016	April 7, 2016	46
	March 22, 2016	May 5, 2016	44
	April 22, 2016	June 9, 2016	48
	May 23, 2016	June 23, 2016	31
	June 22, 2016	July 26, 2016	36
	July 22, 2016	September 1, 2016	41
	August 22, 2016	September 29, 2016	38
	September 22, 2016	November 7, 2016	46
	October 24, 2016	December 1, 2016	38
	November 22, 2016	January 12, 2017	51
	December 22, 2016	February 9, 2017	49
2017	January 23, 2017	March 2, 2017	39
	February 22, 2017	April 6, 2017	45
	March 22, 2017	May 11, 2017	50
	April 24, 2017	June 1, 2017	38
	May 22, 2017	June 29, 2017	38
	June 22, 2017	July 27, 2017	35
	July 24, 2017	August 24, 2017	31
	August 22, 2017	September 26, 2017	37
	September 22, 2017	November 5, 2017	45
	October 23, 2017	December 7, 2017	45
	November 22, 2017	January 4, 2018	43
	December 22, 2017	January 22, 2018	31

Source: Agency's Financial System (SAP)

Procurement Card Audit



All other Credit Programs

Credit Card	Vendor	Agency Policy	Number of Cardholders	2015 Total Spending	2016 Total Spending	2017 Total Spending
P-Card (Visa)	US Bank	A-89 January 28, 2016	17-19	\$ 223,587	\$ 301,439	\$ 221,000
Travel Card (Mastercard)	Bank of America	A-55 May 25, 2015	7 -10	138,855	189,503	194,250
Fuel Card	US Bank – Voyager Fleet Systems	A-86 February 4, 2013	177	116,701	102,692	102,251
Home Depot	Home Depot	None	42	50,313	50,921	52,277
Smart & Final	Smart & Final	None	3	5,047	5,028	4,929
Sam's Club	Sam's Club	None	1	Not Open	Not Open	No Activity
Totals			Approx. 250	\$ 534,503	\$ 649,583	\$ 574,707

IA Review

- Agency Policy A-89
- Role of the P-Card Administrator
- Improve processes for approving and reconciling transactions
- Consolidation of credit cards
- Maximize rebate earnings

Procurement Card Audit

	2016	2017
Rebate Received	\$3,870	\$4,259
Potential Rebate Scenario 1	\$8,750	\$7,559
Potential Rebate Scenario 2	\$9,571	\$8,268



The End Questions or Comments?

The Procurement Card Audit is consistent with the Agency's Business Goals of Fiscal Responsibility, Workplace Environment and Business Practices by having the Internal Audit Department provide an independent evaluation of the P-Card program and provide recommendations for improvements, identify cost containment opportunities, evaluate policy compliance and monitoring the control environment of the Agency.

Audit Committee

INFORMATION

ITEM

2C

Date: March 21, 2018

To: The Honorable Board of Directors

From: Teresa Velarde, Manager of Internal Audit

Committee: Audit

03/12/18

Subject: Internal Audit Department Quarterly Status Report

Executive Summary:

The Audit Committee Charter requires that a written status report be prepared and submitted each quarter. The Internal Audit Department Status Report includes a summary of significant internal and external audit activities for the reporting period. During this quarter, Internal Audit staff worked on the following major projects:

- Required filings of the Annual Financial Statements and Single Audit Report
- Wire Transfers Audit
- P-Card Audit
- Other on-going audit projects and requests

IA continues to assist with any requests for audit work, review of Agency policies and procedures and recommendations for internal controls as well as work on routine audit projects as specified in the Annual Audit Plan. The attached report provides details and information.

Staff's Recommendation:

This is an information item for the Board of Directors.
Provide direction for future IA projects and reviews.

Budget Impact Budgeted (Y/N): Y Amendment (Y/N): Y Amount for Requested Approval:

Account/Project Name:

N/A

Fiscal Impact (explain if not budgeted):

N/A

Prior Board Action:

On March 15, 2017, the Board of Directors reconfirmed the approved Audit Committee and the Internal Audit Department Charter

Environmental Determination:

Not Applicable

Business Goal:

The Status Report is consistent with the Agency's Business Goals of Fiscal Responsibility, Workplace Environment and Business Practices by describing IA's progress in providing independent evaluations and audit services of Agency financial and operational activities and making recommendations for improvement and to assist the Agency in achieving organizational goals.

Attachments:

Attachment 1 - Internal Audit Department Status Report for March 2018

Attachment 2 - IIA Global Perspectives: Internal Audit and External Audit Distinctive Roles in Organizational Governance

Attachment 3 - Los Angeles Times Article: Five face charges in probe of rural water district, dated February 23, 2018

Internal Audit Department Status Report for March 2018

Planned/Future/Additional Projects

Project: Follow-Up Audits & Outstanding Recommendations

Status: On-going Monitoring

Scope:

The Internal Audit Department Charter requires Internal Audit (IA) to follow-up on the status of outstanding recommendations to determine if corrective actions have been taken. The follow-up reviews are scheduled through the Board-approved Annual Audit Plan. Executive Management supports the implementation efforts of the recommendations previously provided and/or the development of alternative controls to address the original risks identified.

The table below provides the number of recommendations outstanding as of this Status Report. Additional details related to each of the outstanding recommendations is submitted with the Annual Audit Plan in June each year. This summary is to provide an update on the status of the follow up audits and the related outstanding recommendations. This summary includes new recommendations provided during this calendar year as well as considers any recommendations cleared during the year. Follow up reviews are part of the on-going monitoring activities IA performs according to the requirements of the IAD Charter. Follow up review is typically scheduled between 12 – 18 months from the date of the original audit, to allow time for full implementation. If a recommendation is deemed to be not implemented, the recommendation continues to stand or alternate controls to mitigate any risks are evaluated to determine if the risk has been addressed and the recommendation is longer applicable. Follow up review is also scheduled if requested sooner by the Audit Committee or Executive Management. The audited business units are encouraged to submit for IA review, additional information if they determine the recommendation has been satisfied.

Area Audited	Report Issued Date	No. of Recs. Remaining to be Verified by IA	Planned Follow-Up
Payroll Audit	August 24, 2010	1	Annually
Intercompany Receivables - Watermaster	August 30, 2011	1	FY2018
SCE Utility Payments	August 28, 2013	1	FY2018
Accounts Payable Follow-Up	August 29, 2013	9	FY2018
Automobile Insurance Requirements	March 3, 2014	2	FY2018
Vehicle Security Procedures	March 3, 2014	3	FY2018
Vehicle Inventory Procedures	March 12, 2014	13	FY2018
Follow-Up – IT Equipment Audit – ISS	February 29, 2016	2	FY2019
Master Trade Contracts	September 1, 2016	6	FY2019
Follow-Up – IT Equipment Audit – FAD	December 5, 2016	6	FY2019
Audit of Master Services Contracts	December 5, 2016	3	FY2019
2017 Petty Cash Audit & Follow-Up Review	June 5, 2017	7	FY2020
Water Use Efficiency Programs Audit	June 5, 2017	6	FY2020
Contracts and Procurement Follow-Up Audit	August 30, 2017	1	FY2020
Payroll Operations Audit	August 30, 2017	6	FY2020
Total Outstanding Audit Recommendations		67	
Recommendations related to the Regional Contract Review (these recommendations are planned for full implementation with the renegotiation of the Regional Contract IA will not follow up on these items until the renegotiation has been finalized)			
Regional Contract Review – Final Audit Report	December 16, 2015	31	Pending – Renegotiation of the Regional Contract

Internal Audit Department Status Report for March 2018

Projects Completed This Period

Project: Filing of the Annual Financial Statements and Single Audit Report

Scope: Submit the required audited financial reports to the requesting reporting authorities

Status: COMPLETED

Completed the required filings with the State Controller's Office, the San Bernardino Auditor-Controller and the State Water Resources Control Board. These filings are mandatory and IEUA must complete the filings by March 31st of each year. Internal Audit Department takes the lead to file the reports with the required agencies. Upon being notified of additional required filings, IA will assist and comply with any additional filing requirements.

Project: Procurement Cards (P-cards) Audit

Scope:

The objectives of the P-Card audit were to determine if P-Card purchases comply with the Agency's Procurement Ordinance Number 101, Agency Policy A-89 (Procurement Card Program), department Standard Operating Procedures, and procurement processes. Additionally, to determine the adequacy of internal controls in place and to identify improvements for the effectiveness and efficiency of the program.

Status: COMPLETED

IA reviewed the P-Card activity for a 24-month period, January 2016 through December 2017. Approximately 1,700 P-Card transactions totaling \$500,000 were processed during the two-year period to procure goods and services by approximately 18-20 P-Card users.

IA worked with the Contracts and Procurement Department (CAP) and Finance and Accounting Department (FAD) during this audit. IA reviewed the controls and processes in place over the P-Card program and the documentation to support the purchases. For the Agency's P-Card program, IA identified key areas of concern that require further review by CAP and FAD.

IA provided recommendations to improve the Agency-wide P-Card program to: Update the Agency Policy A-89, strengthen the role of the P-Card Administrator, explore options and tools available through the P-Card Issuer (US Bank) to improve the reconciliation process, and consider consolidation of most Agency credit card programs (and possibly increase the rebates received).

The report is provided under a separate cover.

Project: Wire Transfers Audit

Scope:

The objectives of the Wire Transfers audit were to evaluate internal controls and segregation of duties for the initiation, authorization and fulfillment of wire transfer and EFT payments, to verify that transactions are accurate, complete and timely, and to identify improvements for the effectiveness and efficiency of processing transactions.

Status: COMPLETED

IA worked closely with the Finance and Accounting Department. The audit found that, in general, FAD has effective controls in place to ensure that wire transfers are authorized, supported, accurate, timely and valid. IA made several recommendations about additional potential automation, updating Standard Operating Procedures and ensuring adequate and complete documentation of transactions in SAP, the Agency's accounting system. Additionally, IA recommended that the Agency perform a cost/benefit analysis of the advisability of increasing Fraud Transfer Insurance policy limits and aligning the bank's call-back procedure with those limits.

The report is provided under a separate cover.

Internal Audit Department Status Report for March 2018

Project: Annual Audit Plan**Scope:**

According to the Board-approved Internal Audit Charter, the Manager of IA must annually submit a documented plan of proposed audit projects. The Annual Audit Plan is prepared in accordance with recommendations and best practices provided by the Institute of Internal Auditors (IIA). The Annual Audit Plan allows the Manager of IA to carry out the responsibilities of the IAD by prioritizing projects and allocating necessary resources where audit efforts are deemed appropriate and necessary. The audit projects proposed are selected and scheduled based on a risk assessment to target the areas of highest risk in terms of impact and likelihood. The audits, and resulting recommendations are intended to assist Agency management and the Board in achieving organizational goals and objectives.

During the next weeks, IA will be performing a risk assessment and asking questions about where audit efforts would provide the greatest value to the Agency and assist with mitigating risks. During this period, IA solicits input, feedback and information about potential audit areas or potential risks that could prevent the Agency from achieving organizational goals. Audit areas and risks are ranked according to a methodology prescribed by the IIA. A complete Annual Audit Plan will be submitted for discussion and approval during the next regularly scheduled Audit Committee Meeting.

On-going Projects**Project:** Management Requests**Scope:**

Assist Agency Management with requests for analysis, evaluations and verification of information, assist with the interpretation of policies and procedures, and/or provide review and feedback on new policies or procedures. These services are provided according to the IA Charter, the Annual Audit Plan, and best practices. The management request projects are short-term projects, typically lasting no more than 60 – 75 hours each where IAD determines it has the necessary staff, skills and resources to provide assistance without having to delay/defer scheduled audits and priority projects. The scope of each review is agreed upon between the department manager requesting the evaluation/review/analysis/assistance and the Manager of IA and when deemed appropriate by Executive Management.

During this quarter, IA was working on the following “Management Requests”:

- Participated in Meetings related to the Network Security/Vulnerability Assessment, specifically, during this quarter IA worked closely with BIS and IT to determine, evaluate and rank the different types of Agency systems and data to evaluate the potential impact.
- Continued to assist with policy language interpretation.
- Participated in IT Security Committee
- Participated in the Safety Committee
- Participated in the Employee Engagement Survey workgroups
- Participated in Disaster Preparedness Training which included a day-long training on Federal Government forms and requirements.

Project: Special Projects**Scope:**

Perform special reviews and projects including analyzing transactions, evaluating documents and policies, verifying information, assisting with interpretation of Agency Policies or other required procedures, and providing recommendations and feedback on results of the analysis, engaging necessary assistance if and/or when necessary, reporting to the General Manager and the Audit Committee. These services are provided according to the IA and Audit Committee Charters, the Annual Audit Plan, and/or best practices.

Special Projects can be short or long-term projects, typically requiring more than 80 hours of staff time and typically requiring setting aside or delaying work on scheduled audit projects. The scope of the review is not

Internal Audit Department Status Report for March 2018

typically known and the work must be handled with the highest degree of confidentiality and care, typical of all audit projects. Typically, Special Projects are considered highly confidential.

Current Trends in Internal Audit

The attached guidance *Global Perspectives: Internal Audit and External Audit* was prepared by the Institute of Internal Auditors (IIA) to provide an overview on the key differences between Internal Audit and External Audit. Specifically, it discusses the functions, roles, professional guidelines/standards that must be followed, and focus areas of audits. Both contribute to the organizational governance of the Agency and each have distinct scopes of audit and intended audiences. The publication is provided for your review.

A recent article from the LA Times is also attached for your review. The article titled *Five face charges in probe of rural water district*, dated Friday, February 23, 2018 discusses the results of a State Controller's Audit that uncovered recent fraud related to the misuse of public agency credit cards in addition to the improper disposal of hazardous waste without permits left leaking into the ground. This article is the most recent example of many that reinforces the need for tight internal controls including written policies, employee training and continuous oversight of the use of credit cards. IA recently completed the Procurement Card audit and makes recommendations for tightening internal controls.

Internal Audit Department

Internal Audit Department Staffing:

The Internal Audit Department is staffed as follows:

- 1 Full-time Manager of Internal Audit
- 2 Full-time Senior Internal Auditors

Internal Audit Staff Professional Development Activities:

As required by the *International Standards for the Professional Practice of Internal Auditing*, auditors should continue to enhance their knowledge, skills, and other competencies through continuing professional development.

The Internal Audit Manager is a member of the governing board of the Inland Empire Chapter of the Institute of Internal Auditors (IIA). The governing board sets direction for the chapter.

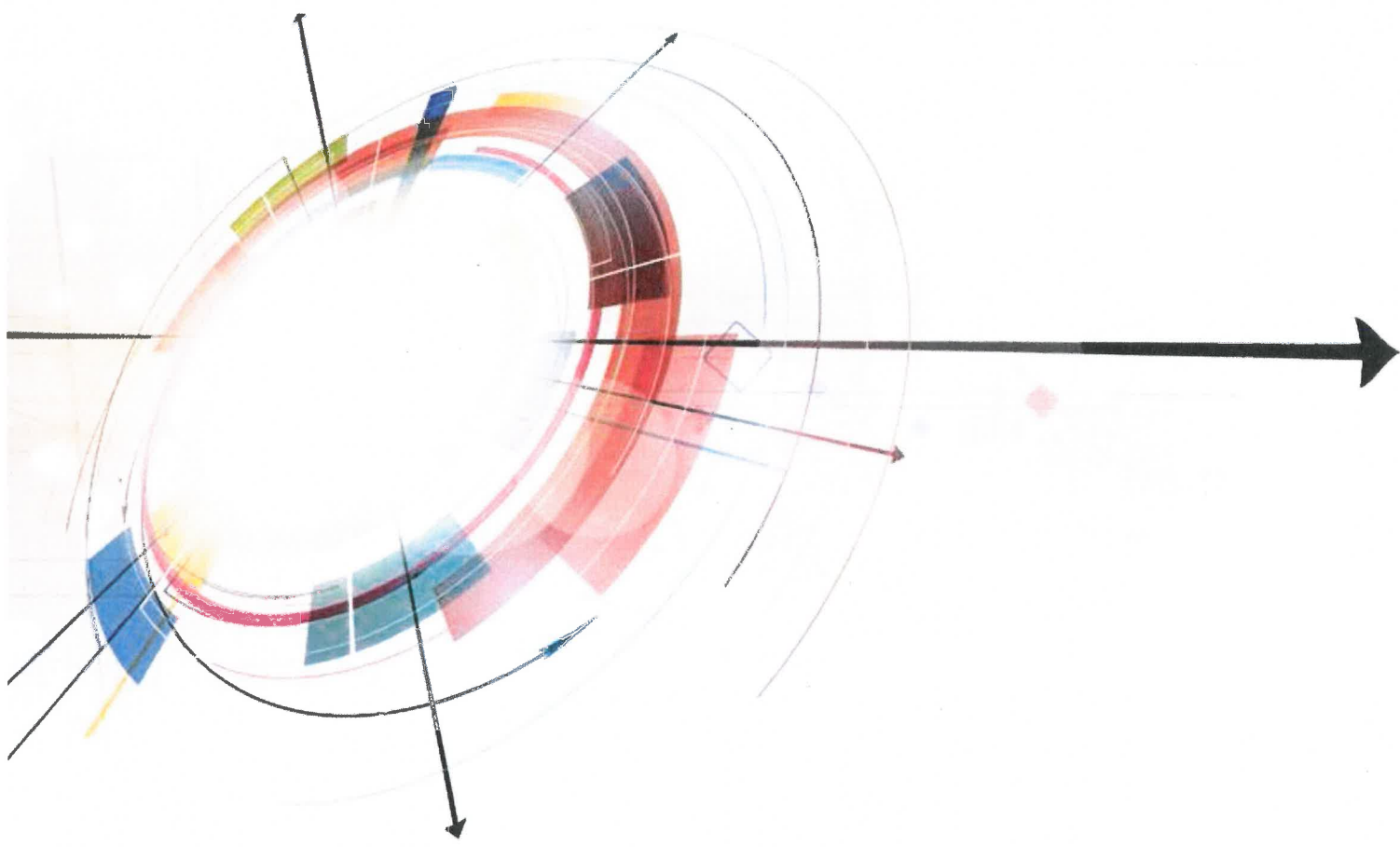
During the past quarter, IA staff has continued to stay abreast of industry developments through review of industry periodicals and participation in free IIA sponsored, on-line webinars. The Manager of Internal Audit attended the annual CSMFO conference held in Riverside during February 2018. Trainings attended this quarter are provided by the IIA on relevant audit trends.

All three IA members are preparing for the third exam of the 3-part Certified Internal Auditor (CIA) certification examination. The CIA is the only globally-recognized certification for internal audit professionals and is the highest certification that can be attained by an internal auditor.

In July 2017, the Manager of IA passed the examination for the Certified Government Auditor Professional designation and was certified by the IIA as a CGAP. The Certified Government Auditing Professional® (CGAP®) certification program is designed for auditors working in the public sector and demonstrates government knowledge and expertise. The Manager of IA also has a Master's degree in Public Administration. One Senior Auditor is a Certified Public Accountant (CPA). One Senior Auditor is a Certified Government Audit Professional (CGAP).

Future Audit Committee Meetings:

- Monday, June 11, 2018 – Regularly Scheduled Audit Committee Meeting
- Monday, September 10, 2018 – Regularly Scheduled Audit Committee Meeting
- Monday, December 10, 2018 – Regularly Scheduled Audit Committee Meeting



Issue 8

GLOBAL PERSPECTIVES AND INSIGHTS

Internal Audit and External Audit

Distinctive Roles in Organizational Governance

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Previous Issues

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Reader Feedback

Send questions or comments to
globalperspectives@theiia.org.

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Internal Audit and External Audit

Distinctive Roles in Organizational Governance

Executive Summary

The interests, roles, responsibilities, and activities of internal auditors and external auditors are complementary and sometimes similar; in some cases, they overlap at one point or another. For example, the overlap between an internal auditor and an external auditor may include carrying out an efficient analysis of transactions; becoming intimately familiar with an organization's governance, risk management, and internal control systems; and sharing and developing accurate final reports.

This is not a surprise; each role is based on a professional discipline and operates to that discipline's standards. As such, the external auditor's professional concerns include the inaccuracies and misstatements that affect final

business accounts (financial information). Internal auditors are concerned with the wide range of governance, risk management, and internal controls (nonfinancial information). Keep in mind, internal audit and external audit do not compete and they do not conflict; rather, one complements the other. Both are crucial to good governance, and they should meet at some point and work together.

However, there are distinct differences in the roles, and certainly in the boundaries of the work that they perform. The differences, summarized below, are often under-recognized, and are perhaps even misunderstood and confused by stakeholders.

Key Differences Between Internal and External Audit		
	Internal Audit	External Audit
Purpose	Analyze and improve controls and performance	Express an opinion on the financial condition
Scope	Organizational operations	Fiscal financial records
Skills	Interdisciplinary	Accounting, finance, tax
Timing	Present/future, ongoing	Past, point in time
Primary Audience	Board, executive management	Investors, public interests
Standards	The IIA's <i>International Standards for the Professional Practice of Internal Auditing</i>	Generally Accepted Auditing Principles, Generally Accepted Auditing Standards
Focus	Enhance and protect organizational value	Fair representation of financial statements
Employment Relationship	An organization's employee	A contracted third party

Functions

Define and Distinguish

The internal auditor and the external auditor, jointly, are indispensable for good governance, with the internal auditor focusing on all nonfinancial information.”

—John Bendermacher, IIA–Netherlands

Internal Audit

The IIA defines internal auditing as “an independent objective assurance and consulting activity designed to add value and improve an organization’s operations, it helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.”

- Internal audit professionals have backgrounds in various academic disciplines, and no single discipline is required.
- According to The IIA, an internal audit engagement is “a specific internal audit assignment, task, or review activity, such as an internal audit, control self-assessment review, fraud examination, or consultancy. An engagement may include multiple tasks or activities designed to accomplish a specific set of related objectives.
- Internal auditors are employed by the organization, but are independent of the activities they audit. Because independence is imperative to be effective, the internal auditor ideally reports directly to the board.
- Internal auditors must conform with The IIA’s *International Standards for the Professional Practice of Internal Auditing*.

External Audit

On the other hand, external auditors are professional accountants.

- According to the International Federation of Accountants (IFAC), an audit engagement is “a reasonable assurance engagement in which a professional accountant in public practice expresses

an opinion whether financial statements are prepared, in all material respects (or gives a true and fair view or are presented fairly, in all material respects), in accordance with an applicable financial reporting framework, such as an engagement conducted in accordance with International Standards on Auditing. This includes a Statutory Audit, which is an audit required by legislation or other regulation.”

- Unlike internal auditors, external auditors are not employees of the organization — they are third parties, and therefore, have no vested interest in the organization.
- Globally, external auditors are guided by the International Auditing and Assurance Standards Board (IAASB) International Standards on Auditing.

Roles

There Really Is a Difference

“A well-resourced and independent internal audit function is uniquely positioned inside organizations to provide objective assurance on the risks that matter most.”

—Carolyn Saint, IIA-North America

In some jurisdictions, an internal auditor is made *mandatory* by corporate governance codes or regulatory rules. This is a recognition of internal audit’s value to an organization. Internal audit saves organizations money, protects reputations, and paves the way to success. At its simplest, internal audit identifies the risks that could keep an organization from achieving its goals, alerts leaders to these risks, and proactively recommends improvements to help reduce the risks. Examples include:

AUDIT FOCUS

IIA Standard 1100: Independence and Objectivity

The internal audit activity must be independent, and internal auditors must be objective in performing their work.

- Detect wasteful spending.
- Identify red flags.
- Verify records and financial statements.
- Assess compliance with rules and regulations.
- Investigate fraud.
- Promote ethics.
- Inform senior management and the board.
- Identify risks and provide assurance over controls.

Internal audit *partners* with management and the board, and focuses on the complete health of the organization, which includes serving the overall needs of the organization, focusing on present and future events of the organization, and ensuring the accomplishment of goals and objectives. The external auditor's primary function — again as a third party — is to provide an opinion on whether the accounts show a true and fair view of the financial statements, and they are incidentally concerned with the prevention and detection of fraud. Beyond those basic functions, an external auditor provides no deeper benefit to the organization.

An organization should never consider using an external auditor to perform the internal audit function. This line of thinking is very dangerous.

External audit firms do not drill down into the organization's governance, risk management, and internal control operations; if for no other reason than, the purpose and the role does not require it. The external audit function is active only annually (at year-end), and is not able to provide immediate and preventative advice and insight into what will add value to an organization — external audit is completely independent of the organization.

“In my experience, I have found that internal auditors communicate why things need to change, and then follow up with mentoring and training of staff across the entire organization.”

—Karem Toufic Obeid, IIA–United Arab Emirates

In contrast, internal audit has a constant presence in the organization. Unlike external auditing, internal auditing serves the needs of the organization through its

AUDIT FOCUS

IIA Standard 2070: External Service Provider and Organizational Responsibility for Internal Auditing

When an external service provider serves as the internal audit activity, the provider must make the organization aware that the organization has the responsibility for maintaining an effective internal audit activity.

dedication to all controls *fundamental* to achieving the organizational objectives: governance, risk management, and internal control, and nowadays, more and more, also to covering culture and behavior. Its overall mission concerns providing organizations with assurance on and insight into their business practices, thereby enhancing organizational value.

To this end, internal audit advises management and the board on governance, risk management and control processes, and discusses — on more than an annual basis — the subject of sound internal control systems. To be effective, internal audit suggests improvements to management. As employees of the organization, internal audit has a vested interest in the organization's competencies in these areas.

“Internal audit needs to provide the board with insight into the nature and roles of all assurance providers, including internal and external auditors, and second line of defense functions.”

—Hans Nieuwlands, IIA–Netherlands

While internal and external auditing techniques are similar, the intended outcomes vary greatly. For example, voicing concern if there is no understanding about the importance of procedures may be addressed differently by an internal auditor and an external auditor because of differing objectives. According to The IIA, internal audit's mission is “to enhance and protect organizational value by providing risk-based and objective assurance, advice, and insight.” Internal audit's attention is on whether an organization's

business practices are assisting the business to meet *all* of its objectives, while recognizing and managing its risks — those that are obvious, and those that are not so obvious.

Identifying and Managing Risks

The Three Lines of Defense Model

“Audit committees need operational information, and although external audit’s role is outside of the Three Lines of Defense, it is in a position to ‘watch the perimeter.’ That contribution is vital and complementary.”

—Nur Hayati Baharuddin, IIA-Malaysia

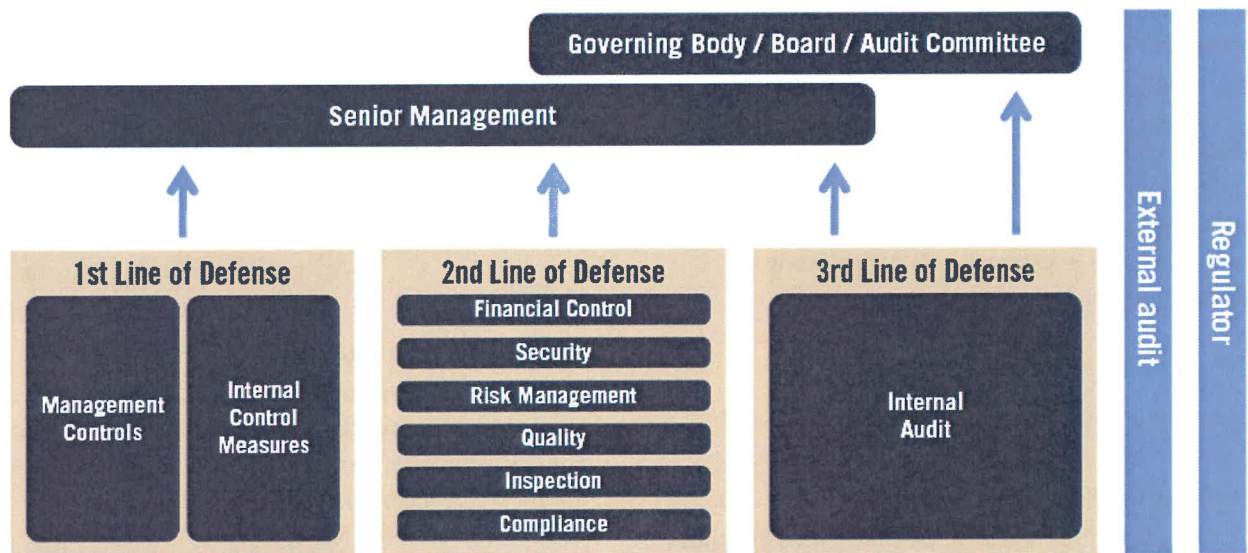
Anything important is worth protecting. Unrecognized risks will negatively affect an organization sooner or later. The IIA Position Paper “The Three Lines of Defense in Effective Risk Management and Control” discusses the fact that “duties related to risk management and control must be coordinated carefully to assure that risk and control processes operate as intended.” Further, the position paper provides direction to clarify important roles and duties to develop those risk management

initiatives. It states, “Establishing a professional internal audit activity should be a governance requirement for all organizations. This is not only important for larger and medium-sized organizations, but also may be equally important for smaller entities, as they may face equally complex environments with a less formal, robust organizational structure to ensure the effectiveness of its governance and risk management processes.”

The Three Lines of Defense model, illustrated below, states, “Without a cohesive, coordinated approach, limited risk and control resources may not be deployed effectively, and significant risks may not be identified or managed appropriately. Clear responsibilities must be defined so that each group of risk and control professionals understands the boundaries of their responsibilities and how their positions fit into the organization’s overall risk and control structure.”

Operational management, the first line of defense in risk management, is responsible for maintaining effective internal controls on a day-to-day basis. The controls are designed and executed under management’s guidance, and performed by their employees (e.g., accounting). *Risk management, compliance, and other functions* — again established by management — comprise the

The Three Lines of Defense Model



Adapted from ECIIA/FERMA *Guidance on the 8th EU Company Law Directive, article 41*

second line of defense, which supports management policies and assists risk owners to define target risk exposure within multiple compliance functions (e.g., safety, supply chain, etc.).

The second line of defense is responsible for disseminating risk-related information throughout the organization. Internal audit is solely the third line of defense, and actively and continuously contributes to effective organizational governance, risk management, and internal controls (e.g., operations, assets, regulations, contracts, etc.). Internal audit provides independent assurance, and assesses the effectiveness of the processes created in the first and second lines of defense. External audit's role is outside of the model, but it is important to have for assurance over financial reporting processes.

Working Together

[“Internal audit partners with management and the board, and focuses on the complete health of the organization.”](#)

—Ana Cristina Zambrano, IIA-Colombia

The January 2017 *Internal Auditor* magazine article [“Mapping Assurance”](#) stated it plainly, “When it comes to providing assurance, internal audit isn't the only player in the game. Boards and executives seek assurance information on the effectiveness of an organization's governance from a variety of internal and external sources, including external auditors.”

Identifying risk is one of the most important tasks to perform while conducting an audit. The U.S. Office of the Comptroller of the Currency's (OCC) *Comptroller's Handbook* suggests that while external auditing's role is outside of the Three Lines of Defense model, risks (e.g., operation, compliance, strategic, and reputation) can be identified by both internal auditors and external auditors. The difference is that external auditors take no action to help eliminate the risk.

Recognizing the difference in roles and duties, internal and external auditors, in many instances, already work together. They work together to not only cover the full area of financial and nonfinancial information, but also to avoid unnecessary overlap in execution of audit

AUDIT FOCUS

IIA Standard 2050: Coordination and Reliance

The chief audit executive should share information, coordinate activities, and consider relying upon the work of other internal and external assurance and consulting service providers to ensure proper coverage and minimize duplication of efforts.

procedures by sharing risk assessments, reports, and other information — formally and informally. Internal and external audit working together increases the effectiveness of the total audit efforts made, and is beneficial to the board and the audit committee.

As stated earlier in this report, the internal auditor's interests and responsibilities and the external auditor's interests and responsibilities complement one another, which is a good practice. The Implementation Guide for Standard 2050 states, “The CAE meets with each of the providers to gather sufficient information so that the organization's assurance and consulting activities may be coordinated.”

“Allies in Governance 2.0,” published by IIA–Netherlands (2016) states, “The roles of the external auditor and the internal auditor go hand-in-hand. Clear positioning, optimum collaboration, and knowledge sharing are key in this respect.”

Closing Thoughts

Internal Audit: Constant and on Behalf of the Organization

“Internal audit reports on the overall health and well-being of the organization, and is indispensable to effective governance, risk management, and control.”

—Lesedi Lesetedi, African Federation IIA

In closing, effective organizational governance requires a robust, independent internal audit function — a very necessary part of healthy, successful business practices.

Internal audit's efforts are purposely centered on governance, risk management, and internal control. As employees of the organization, albeit in an independent role, internal auditors are fully vested in the organization's successes, and their concern is to cover *all* organizational operations on a continuous basis. At the conclusion of an audit engagement, internal auditors are careful to deliver thorough "made-to-order" reports to the board and/or audit committee that include specific and detailed conclusions about how risks and objectives are currently known and being managed.

In addition, internal audit's reports include well-thought-out suggestions for continuous improvement, and help the entire organization accomplish goals and objectives to improve internal control and eliminate identified risks. The bottom line? Internal audit is *the key*. To ensure that an organization creates short-, medium-, and long-term value, internal auditing is the undeniable answer, and the internal audit function is best performed by *qualified individuals* working within a well-resourced and independent internal audit function.

For More Information

- International Federation of Accountants (IFAC), "Handbook of the Code of Ethics for Professional Accountants," 2010 (www.ifac.org).
- The IIA "Implementation Guide 1100: Independence and Objectivity," available to members only, January 2017 (www.theiia.org).
- The IIA "Implementation Guide 2070: External Service Provider and Organizational Responsibility for Internal Auditing," available to members only, January 2017.
- The IIA Position Paper "The Three Lines of Defense in Effective Risk Management and Control," 2013 (www.theiia.org).
- The IIA *Internal Auditor* magazine "Mapping Assurance: Internal auditors can facilitate efforts to document the organization's combined assurance activities," Y.S. Al Chen, Loïc Decaux, and Scott Showalter, Dec. 2016 (www.theiia.org).
- The IIA "Implementation Guide 2050: Coordination and Reliance," available to members only, January 2017 (www.theiia.org).
- IIA–Netherlands, "Allies in Governance 2.0: Towards a sustainable relationship between the Audit Committee and the Internal Audit Function," September 2016 (www.ii.nl).

About The IIA

The Institute of Internal Auditors (IIA) is the internal audit profession's most widely recognized advocate, educator, and provider of standards, guidance, and certifications. Established in 1941, The IIA today serves more than 190,000 members from more than 170 countries and territories. The association's global headquarters are in Lake Mary, Fla., USA. For more information, visit www.globaliia.org.

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Five face charges in probe of rural water district

By ALENE TCHEKMEDEYIAN

It started a year ago when state investigators uncovered 88 drums holding thousands of gallons of hazardous waste illegally buried in a rural Central Valley water district yard.

Their probe quickly widened to include allegations of misconduct that were revealed in a state audit. Soon, authorities said, they discovered that officials running the Fanoche Water District misused more than \$100,000 in public funds on various personal items and expenses, including slot machines, concert tickets, home improvements and Porsche upgrades.

Now, five current and former water district officials — including former General Manager Dennis Falaschi — are facing felony charges in the corruption probe, according to the California attorney general's office.

Four have been arrested, and one is expected to surrender Friday, said the state Department of Toxic Substances Control.

It is unclear whether any of the accused have retained attorneys.

"In California, those in public posts who abuse the public's trust for personal gain will be held accountable," Atty. Gen. Xavier Becerra said in a statement.

Authorities said Thursday that Falaschi ran the agency "as his own personal operation and bank account" between 2011 and 2016. He faces eight felony charges, including six counts of embezzlement and misappropriation of public funds.

Also charged were Julie Cascia, the district's former office manager, who allegedly used department-

issued credit cards and money orders for personal expenses, and Falaschi's son Atomic, who took 1,500 pistachio trees from the agency to use on his own property, according to the complaint.

Two other ex-employees — Jack Hurley and Dubby West — were charged with disposing barrels of hazardous waste without permits.

When authorities dug up the buried waste last year, they discovered that the drums — which contained chlorine, caustic soda, iron chloride and a mixture of used antifreeze, solvents and oil — were leaking into the ground. Officials said Thursday that the contamination is being cleaned up.

Cascia and West were also charged with illegally transporting hazardous waste to a landfill in Los Banos, officials said.

The district, which serves an area of about 38,000 acres, delivers water to western Merced and Fresno counties.

The alleged misconduct was first identified by state auditors, who last year released a scathing report lambasting the district for providing employees with perks including free housing, interest-free loans and credit cards used to pay for sports and concert tickets.

Reimbursement collection procedures were so lax that one employee did not repay personal expenses charged to the district for nearly three years, according to the audit.

At the time, state Controller Betty T. Yee called the "shocking" lack of spending oversight "especially troubling in a region where effective water governance is so vital for the agricultural community."

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