



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

**WEDNESDAY, SEPTEMBER 20, 2017
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 ITEMS

A. MINUTES

The Committee will be asked to approve the Audit Committee meeting minutes from June 12, 2017.

2. INFORMATION ITEMS

**A. CONTRACTS AND PROCUREMENT FOLLOW-UP AUDIT (WRITTEN/
POWERPOINT)**

B. PAYROLL OPERATIONS AUDIT (WRITTEN/POWERPOINT)

**C. INTERNAL AUDIT DEPARTMENT STATUS REPORT FOR SEPTEMBER
2017 (WRITTEN)**

3. GENERAL MANAGER'S COMMENTS

- 4. **COMMITTEE MEMBER COMMENTS**
- 5. **COMMITTEE MEMBER REQUESTED FUTURE AGENDA ITEMS**
- 6. **CLOSED SESSION**
 - A. **PURSUANT TO GOVERNMENT CODE SECTION 54956.9(d)(4)
CONFERENCE WITH LEGAL COUNSEL - ANTICIPATED LITIGATION;
INITIATION OF LITIGATION**
One (1) Case

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: *AL*

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, September 14, 2017.

 April Woodruff
April Woodruff

**ACTION
ITEM**

1A



**MINUTES
AUDIT COMMITTEE MEETING
INLAND EMPIRE UTILITIES AGENCY*
AGENCY HEADQUARTERS, CHINO, CA
MONDAY, JUNE 12, 2017
9:00 A.M.**

COMMITTEE MEMBERS PRESENT

Kati Parker, Chair
Steven J. Elie

COMMITTEE MEMBERS ABSENT

None

STAFF PRESENT

Chris Berch, Executive Manager of Engineering/AGM
Javier Chagoyen-Lazaro, Manager of Accounting & Fiscal Management
Michael Dias, Assistant Engineer
Sally Lee, Executive Assistant
Suresh Malkani, Principal Accountant
Lisa Morgan-Perales, Senior Water Resources Analyst
Sapna Nangia, Senior Internal Auditor
Christina Valencia, Executive Manager of Finance & Administration/AGM
Teresa Velarde, Manager of Internal Audit

OTHERS PRESENT

Jean Cihigoyenette, JC Law Firm
Debbie Harper, LSL
Travis Hickey, Audit Committee Advisor

The meeting was called to order at 9:00 a.m. There were no public comments received or additions to the agenda.

ACTION ITEMS

The Committee:

- ◆ Approved the Audit Committee meeting minutes of March 6, 2017.

Recommended that the Board:

- ◆ Approve the FY 2017/18 Annual Audit Plan; and
- ◆ Direct the Manager of Internal Audit to finalize the FY 2017/18 Annual Audit Plan.

as a Consent Item on the June 21, 2017 Board meeting agenda.

INFORMATION ITEMS

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

- ◆ Follow-Up Review – Human Resources
- ◆ 2017 Petty Cash Audit and Follow-Up Review
- ◆ Water Use Efficiency Programs Audit
- ◆ Internal Audit Department Status Report for June 2017
- ◆ Audit Planning Communication as Required by SAS 114
- ◆ Audit Committee Financial Advisor – Request for Proposal Process

GENERAL MANAGER'S COMMENTS

The Acting General Manager Chris Berch 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.

CLOSED SESSION

The Board went into Closed Session at 9:55 a.m., A. PURSUANT TO GOVERNMENT CODE SECTION 54956.9a(d)(4) – CONFERENCE WITH LEGAL COUNSEL – ANTICIPATED LITIGATION; INITIATION OF LITIGATION: One (1) Case

The meeting resumed at 10:15 a.m., and General Counsel Jean Cihigoyenetché stated that the below-mentioned matters were discussed in Closed Session, and the Board took the following actions:

Regarding Conference with Legal Counsel – Anticipated Litigation; Initiation of Litigation:

One Case

The Board took no reportable action.

With no further business, the meeting adjourned at 10:15 a.m.

Respectfully submitted,

Sally Lee
Executive Assistant

*A Municipal Water District

APPROVED: SEPTEMBER 20, 2017

Audit Committee

**INFORMATION
ITEM
2A**

Date: September 20, 2017

To: The Honorable Board of Directors

Chris Paul for JG
From: P. Joseph Grindstaff, General Manager

Committee: Special Audit Committee

09/20/17

Manager Contact: Teresa Velarde, Manager of Internal Audit

Subject: Contracts and Procurement Follow-Up Audit

Executive Summary:

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

IA performed follow up procedures on two outstanding recommendations from the 2010 and 2012 Contracts and Procurement (CAP) Department audits. This audit identified that both outstanding recommendations have been implemented. One recommendation required CAP management evaluate the authorization roles, in the Agency's financial system, assigned to one employee to ensure adequate segregation of duties existed. The second recommendation required CAP research and retain documentation of a contractor's Federal Debarment status to prove the contractor is not debarred, this was specific for grant-funded projects.

IA provides a new recommendation regarding assigned authorizations to strengthen internal controls assigned to CAP buyers.

Staff's Recommendation:

Receive the Contracts and Procurement Follow-Up Audit as an information item for the Board of Directors.

The Board of Directors may want to provide guidance for any future audits.

Instruct Agency staff to implement the audit recommendation.

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

Account/Project Name:

N/A

Fiscal Impact (explain if not budgeted):

N/A

Prior Board Action:

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

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

On September 19, 2012 the Board received and filed the 2012 CAP Follow-Up Audit Report.

Environmental Determination:

Not Applicable

Business Goal:

The Contracts and Procurement Follow-Up 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.

Attachments:

Attachment 1 - Contracts and Procurement Follow-Up Audit Report

Attachment 2 - Contracts and Procurement Follow-Up Audit PowerPoint



Inland Empire Utilities Agency

A MUNICIPAL WATER DISTRICT

6075 Kimball Avenue • Chino, CA 91708
P.O. Box 9020 • Chino Hills, CA 91709
TEL (909) 993-1600 • FAX (909) 993-1985
www.ieua.org

DATE: August 30, 2017
TO: Honorable Board of Directors

P. Joseph Grindstaff
General Manager

FROM: Teresa V. Velarde
Manager of Internal Audit

SUBJECT: Contracts and Procurement Follow-Up Audit

Audit Authority

The follow-up review was performed under the authority provided by the Inland Empire Utilities Agency (IEUA or Agency) Board of Directors. The Internal Audit (IA) Department's Charter and the Annual Audit Plan require that IA follow up on the status of audit recommendations to determine if corrective actions were implemented. IA completed a follow-up review of the two outstanding recommendations related to the Contracts and Procurement Follow-up Audit.

Audit Objective and Scope

The purpose of this follow-up review was to evaluate the implementation status for the two outstanding recommendations from the 2012 follow-up audit, which have now been implemented. One recommendation required that Contracts and Procurement (CAP) evaluate the authorization roles assigned to procurement staff to ensure there was adequate segregation of duties. The second recommendation required Grant/Contracts and Procurement staff to verify the Federal Debarment Listing, specific to grant-related purchases. IA makes one recommendation related to the assigned authorization roles for procurement staff. IA did not expand the scope of the review to evaluate additional areas or operations within the Contracts and Procurement operations, further reviews will be scheduled through the Board-approved Annual Audit Plan. The attached report provides details of our review.

Audit Techniques:

Audit techniques included:

- Discussions with Agency Staff
- Review of policies and procedures
- Review of supporting documents
- Analysis of user roles within SAP

Water Smart – Thinking in Terms of Tomorrow

Audit Results – Executive Summary

Contracts and Procurement (CAP) department is responsible for the Agency's procurement program and related activities. The two outstanding recommendations from 2012 have been implemented. The bullet points below provide a brief summary:

- **Segregation of Duties:** The original audit agreed with the finding made by the External Auditors regarding the internal control weaknesses presented because one individual had inadequate segregation of duties. This follow up review found that the weakness no longer exists because the employee has retired.
- **Evaluate Authorizations provided to Procurement Staff:** IA identified one new recommendation regarding the segregation of duties. IA recommends CAP evaluate the number of procurement personnel with authority to create a Purchase Requisition (PR), create and modify a Purchase Order (PO) and receive goods. Because CAP assist users in purchasing, there are limited instances when the buyers require the ability to create a PR, create and modify a PO and receive goods. IA recommends either eliminate or reduce the number of authorized procurement members that have the authorized roles. This would further tighten and strengthen internal controls within CAP.
- **Federal Debarment status:** The original audit found that per federal requirements, grant-funded projects should only include contractors and vendors that have never been debarred by the Federal government. The follow-up audit found that for Agency projects with a formal proposal for purchasing of goods and/or services of \$50,000 or more, CAP checks the Federal Debarment Status of the contractor/supplier during the initial phase and documentation is retained as part of the contract file. Agency Policy A-33 and CAP Standard Operating Procedure outlines the process and procedures to be followed for verification of the debarment status.

The Contracts and Procurement Follow-Up 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.

Acknowledgements

We would like to extend our appreciation to CAP and Business Information Services (BIS) staff for their cooperation and assistance during this follow-up review.

Discussions with Management

We provided the results of this follow-up review to Christina Valencia, Chief Financial Officer/Assistant General Manager and Warren Green, Manager of CAP on August 23, 2017, for their review and comments prior to finalizing this report.

Background

The Contracts and Procurement (CAP) department provides a wide variety of services to Agency departments, including Agency-wide contract administration, purchasing and risk services. CAP is responsible for the acquisition of goods and services, including equipment, materials, supplies, and professional services. These business activities are administered and accomplished under the policies, procedures, and practices set forth in the Agency's Board-approved Procurement Ordinance No. 101, which was in effect at the time of this review.

The original audit was issued in November 2008 and provided a total of 25 recommendations to improve contract and procurement operations. In May 2010, a follow-up review was completed to assess the implementation status of the original 25 recommendations. The 2010 follow-up audit report found that 19 recommendations had been implemented, four recommendations remained in progress, one recommendation was no longer applicable and one recommendation remained open. Additionally, IA provided two new recommendations in the report. After the 2010 follow-up review, seven recommendations remained outstanding.

In August 2012, IA performed a second follow-up review and found that of the seven outstanding recommendations, four recommendations had been implemented and three recommendations were in progress and/or outstanding. Subsequently one was resolved and two remained outstanding. This report provides details of the review related to the two outstanding recommendations.

The analysis completed and the recommendations provided during the prior audits were in the following areas: compliance with Agency's ordinance and policies, Procurement Card, Contract Monitoring, Adequate segregation of duties in the Agency's financial system, Internal Customer Satisfaction survey, Key Performance/Workload indicators, and retention of documentation. Future CAP audits will be scheduled through the Annual Audit Plan.

Segregation of Duties

2010 and 2012 Follow-up recommendation # 1: User authorization roles

The Contracts and Procurement Department should ensure adequate separation of duties exist in procurement transactions. Specifically, the functions of creating and approving the Purchase Request, creating the Purchase Order and having the ability to “receive” should involve a second knowledgeable individual.

Status: Implemented

In the 2010 follow-up audit report, both IA and the external auditors raised a concern related to the individuals in the CAP department having conflicting duties in the procurement process. As a result, IA performed a thorough review of the authorization roles assigned to all procurement staff and found that one staff member had the capability to create, approve, and perform receiving functions for procurement transactions. Good internal controls recommend that at least one other individual be involved in the process to ensure the transaction benefits the Agency. The lack of segregation of duties presented a conflict and risk to the Agency. The recommendation provided was to require at least two individuals be involved in the procurement process/transaction to reduce the likelihood of misuse, error, or fraud.

During the 2012 follow-up review, IA found that nothing had changed and the many risks remained:

- Two staff members had the ability to:
 - establish a vendor in the master database,
 - create and approve Purchase Requests (PRs),
 - create a Purchase Order (PO), and
 - receive goods.

One of the two staff members had been assigned the “superuser” transaction code in SAP, which granted unrestricted access to all Fund Management functions. This authority was established to assist with any implementation issues of the Agency’s Enterprise Resource Planning System (SAP) in 2007. Access to the transaction code was available with no restrictions or cutoff date. The same access remained through 2016.

- One staff member had the ability to:
 - create and approve PRs,
 - create a PO, but did not have the authority to receive goods.

This was identified as a weakness in internal controls because a second person would not be involved in the purchase process to ensure and verify that the purchase benefits the Agency and is properly authorized. IA recommended that

CAP address the internal control weaknesses and consider alternative approaches in-lieu of using the “Superuser” transaction code.

SAP User Roles & Superuser access

For the 2017 follow-up review, the Business Information Services Department (BIS) provided IA a report with all the roles and transaction codes assigned to CAP members. In addition, BIS researched to identify all Agency staff with access to the “Superuser” transaction code that provides unrestricted access. The users identified were from the following departments: BIS, Finance and Accounting, and CAP. On May 19, 2017, to mitigate the risks discussed, BIS removed the “Superuser” code. BIS created a new SAP “super” role, which can only be assigned if absolutely necessary and on a temporarily basis.

The CAP staff member with “Superuser”/unrestricted access, identified during the prior audits, has retired and is no longer an Agency employee. BIS’s efforts to mitigate the risk of giving “superuser” access has addressed the concerns of the original finding. Therefore, no further action is required, the recommendation is implemented.

Other Potential Conflicts

During this review, IA noted that staff currently responsible for procurement services also have the ability to create PRs, create and change POs, and receive goods. The combination of these roles may present other potential conflicts in segregation of duties. See table below:

SAP User Roles (Current Assignment at May 19, 2017)

	Create Purchase Requisitions (PRs)	Approve Purchase Requisitions (PRs)	Create and Change Purchase Orders & Contracts (POs)	Receive Goods	Create Purchasing Master Data
Employee # 1		X			
Employee # 2	X		X	X	
Employee # 3		X	X		X
Employee # 4	X		X	X	
Employee # 5	X		X	X	
Employee # 6	X		X	X	
Employee # 7	X		X	X	
Employee # 8	X		X	X	
Employee # 9			X	X	
Employee # 10			X	X	
Number of Employees with access	6	2	9	8	1

The combination of having the ability to create PRs and Receive goods or Create and Change POs and Receive goods potentially puts the Agency at risk. In most situations, the Procurement personnel should not have a need to “Receive” goods, since

procurement staff's role is to assist employees (the customers) in placing the requested orders, and securing the best pricing and terms, they would not be the recipients of those services; therefore, no need to create the PRs or POs or Receive the goods. There are some contracts/services that are managed and handled by the CAP department where there is a need to Create a PR/PO and complete the receiving. There may also be instances where there are emergencies and CAP personnel may assist by creating the PO/PR. Currently, it is unknown how often CAP staff have been required to utilize the roles.

CAP should evaluate the needs of the Agency and the needs of the department and determine if there is a need for the number of employees to have the access noted or to reduce the access within the CAP department. CAP management should evaluate the assigned user roles and consider eliminating or reducing the roles within the department.

CAP Management may want to consider adding the role create Purchasing Master data for the Manager of the Department. The role would allow for vendors to be set up and added to the Master Vendor file in the Agency's financial system. In addition, at least two individuals should have this role to ensure more than one person can establish vendor data and be involved in the process, if and when required.

SAP User Roles (Proposed Changes)

	Create Purchase Requisitions (PRs)	Approve Purchase Requisitions (PRs)	Create and Change Purchase Orders & Contracts (POs)	Receive Goods	Create Purchasing Master Data
Employee # 1		X			X
Employee # 2			X	X	
Employee # 3		X	X		X
Employee # 4			X		
Employee # 5			X		
Employee # 6			X		
Employee # 7			X		
Employee # 8			X		
Employee # 9			X		
Employee # 10			X		
Number of Employees with access	Consider only 1-3	2	9	Consider only 1-3	2

IA provides the following recommendation for consideration:

2017 Recommendation:

- CAP should review the SAP assigned user roles and transaction codes and ensure that good internal controls are followed and no conflicts exist. IA recommends CAP consider eliminating or reducing the ability to Create PRs and Receive Goods, for CAP buyers in order to strengthen internal controls and further reduce risks.***

Department Response: *The Manager of the CAP department will evaluate the needs of the department and determine if and how many procurement personnel require the roles of Purchase Requisitions and Receiving to determine the impact of placing restrictions on those assigned user roles and to ensure adequate segregation of duties exists for Procurement staff to provide service and assistance to Agency departments. The CAP department plans to complete this evaluation by the end of September 2017.*

Verification of Debarment

2010 and 2012 Follow-up recommendation # 2: Grant Related Purchases

For all grant-related procurements, the Contracts and Procurement Department should print the confirmation from the debarment website at the time the vendor debarment is verified. The confirmation should be filed as evidence of verification, to show whether a vendor was debarred or not at time of the procurement.

Status: Implemented

According to the Agency's Procurement Ordinance No.101 (adopted March 15, 2015), Section 3, Number 7 states:

"For procurements fund by a Federal grant, no award shall be permitted to any vendor for any contracts or sub-contract at any tier level for a vendor which is debarred or suspended or is otherwise excluded from or ineligible for participation in Federal assistance programs under Executive Order 12549, "Debarment and Suspension."

The 2010 and 2012 audits revealed that CAP did not retain documented evidence to show that the debarment list was verified prior to making the grant-related procurement. Since the original audits, CAP has updated the Procurement Ordinance, Policy A-33, and Standard Operating Procedure (SOP) CAP-0008, to address the requirements for verification of the Federal Debarment status for contractors/suppliers. Staff was trained to verify debarment and retain documentation.

CAP SOP titled Debarment of Vendor's/Contractors (Document Number: CAP-0008, Version Number: 001, and Version Date: August 15, 2013) provides detailed procedures and requirements for grant-funded projects.

Agency Policy A-33 (Solicitations, Evaluation, and Award Protocols, effective: March 26, 2015, Revision No. 1) states for all procurements of materials, equipment, supplies, consulting and miscellaneous services that is **\$50,000 or greater**, it will occur through a formal solicitation process, which is a process with sealed proposals that is designed specifically for an award based upon criteria other than price alone. The criteria is established by the Agency and it will be used as a basis to make the technical evaluation for the award. In addition, CAP staff has on-going communication with the Grants

department to determine if the Agency's project is grant-fund and if there are any Grantor requirements. CAP documented in detail the necessary steps to verify debarment.

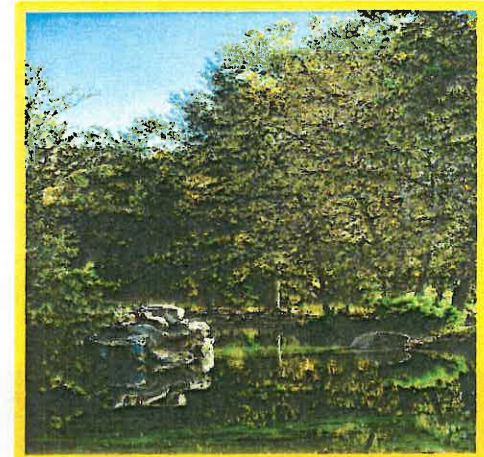
For the 2017 follow-up review, IA selected three grant-related projects from the Engineering and Construction Management Project Quarterly Updates (dated February 2017). IA reviewed the information in the Agency's financial system and selected a vendor that had over \$50,000 in costs incurred, as follows:

Project Number	Project Name	PO Number	Contract Number	Vendor	Amount Paid as of July 31, 2017	Debarment Documentation retained
EN14043.00	RP-5 RW Pipeline Bottleneck	4500026034	4600002205	Stantec Consulting Inc.	\$ 203,712	Yes
EN13001.00	San Sevaine Basin Improvements	4500022155	4600001875	Dudek & Associates Inc	\$ 331,250	Yes
RW15003	Recharge Master Plan Update	4500023271	4600001931	Thomas Harder & Co Inc	\$ 88,128	Yes

For each of the three projects, IA verified that CAP retained the required documentation from the Federal debarment website as required by the Agency Procurement Ordinance and policies. The documentation retained is a hardcopy print-screen from the website (www.sam.gov) showing the contractor's status, which is included as part of the contract file. In each instance tested, the Agency's procedures were followed, therefore IA considers this recommendation to be implemented.

AUDIT COMMITTEE

Contracts and Procurement Follow-Up Audit



Contracts and Procurement Follow-Up Audit

Recommendation # 1: Segregation of Duties

Status: **Implemented**

One Employee had a “superuser role”

- Create a Purchase Requisition
- Approve a Purchase Requisition
- Create Purchase Orders
- Receive Goods
- Create Purchasing Master Data

Contracts and Procurement Follow-Up Audit

SAP User Roles (Current Assignment)

	Create Purchase Requisitions	Approve Purchase Requisitions	Create and Change Purchase Orders & Contracts	Receive Goods	Create Purchasing Master Data
Employee # 1		X			
Employee # 2	X		X	X	
Employee # 3		X	X		X
Employee # 4	X		X	X	
Employee # 5	X		X	X	
Employee # 6	X		X	X	
Employee # 7	X		X	X	
Employee # 8	X		X	X	
Employee # 9			X	X	
Employee # 10			X	X	
Number of Employees with access	6	2	9	8	1

Contracts and Procurement Follow-Up Audit

SAP User Roles (Propose Changes)

	Create Purchase Requisitions	Approve Purchase Requisitions	Create and Change Purchase Orders & Contracts	Receive Goods	Create Purchasing Master Data
Employee # 1		X			X
Employee # 2	X		X	X	
Employee # 3		X	X		X
Employee # 4	X		X	X	
Employee # 5	X		X	X	
Employee # 6	X		X	X	
Employee # 7	X		X	X	
Employee # 8	X		X	X	
Employee # 9			X	X	
Employee # 10			X	X	
Number of Employees with access	1-3			1-3	

Contracts and Procurement Follow-Up Audit

Recommendation # 2: Grant-related Purchases Status: **Implemented**

Agency's Procurement Ordinance :

For procurements funded by a Federal grant, no award shall be permitted to any vendor for any contract or sub-contract at any tier level for a vendor which is debarred or suspended or is otherwise excluded from or ineligible for participation in Federal assistance programs under Executive Order 12549, "Debarment and Suspension.



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The End Questions or Comments?

The Follow-Up review 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: September 20, 2017

To: The Honorable Board of Directors

Committee: Special Audit Committee

Chris P. Grindstaff for JG
From: P. Joseph Grindstaff, General Manager

09/20/17

Manager Contact: Teresa Velarde, Manager of Internal Audit

Subject: Payroll Operations Audit

Executive Summary:

Internal Audit (IA) completed an audit of payroll operations and identified opportunities to strengthen the internal controls and effectiveness of payroll operations. Human Resources (HR) will evaluate alternatives to the manual files used to maintain employee information, such as working with Business Information Systems to develop a self-service portal for employees to make updates and changes directly to certain information that currently requires a hard-copy document. HR will also consider whether the new enterprise content management system provides an automated approach to maintaining and updating employee information. HR will look into securing files in fire-proof and water-proof cabinets. HR will take the lead to promote having all Payroll related payments made through direct deposits to eliminate manual check writing. Finance and Accounting Department (FAD) will work on making updates to SOP PR-08 to reflect the Agency's new payroll process, to match current practice. FAD commits to ensuring that all bank reconciliations are prepared monthly and timely supervisor reviews occur to ensure outstanding and reconciling items are resolved. Lastly, both HR and FAD will encourage payroll staff attends ethics and fraud awareness training specific to their job responsibilities to stay informed of risks and safeguards. IA will take the lead to complete a survey to compare industry best practices in the areas identified through the audit observations.

Staff's Recommendation:

Receive the Payroll Operations Audit as an information item for the Board of Directors.
The Board of Directors may want to provide guidance for any future audits.
Instruct Agency staff to implement the audit recommendations.

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

Account/Project Name:

N/A

Fiscal Impact (explain if not budgeted):

N/A

Prior Board Action:

On June 21, 2017, the Board of Directors approved the Annual Audit Plan for Fiscal Year 2017/18. The Payroll Operations Audit was included in that plan.

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

Environmental Determination:

Not Applicable

Business Goal:

The Payroll Operations Audit is consistent with the Agency's Business Goals of Fiscal Responsibility, Workplace Environment and Business Practices by providing an independent evaluation of IEUA's Payroll Operations and suggesting recommendations for improvements.

Attachments:

Attachment 1 - Payroll Operations Audit Report
Attachment 2 - Payroll Audit PowerPoint



Inland Empire Utilities Agency
A MUNICIPAL WATER DISTRICT

6075 Kimball Ave. • Chino, CA 91708
P.O. Box 9020 • Chino, Hills, CA 91709
TEL (909) 993-1600 • FAX (909) 597-8875
www.ieua.org

DATE: August 30, 2017

TO: P. Joseph Grindstaff
General Manager

Teresa V. Velarde

FROM: Teresa V. Velarde
Manager of Internal Audit

SUBJECT: Payroll Operations Audit

Audit Authority

The Inland Empire Utilities Agency (IEUA or Agency) Internal Audit Department (IA) performed an audit of Payroll operations. 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 that discusses the results of the audit and includes IA's observations and recommendations.

Audit Scope

The Payroll Operations Audit objectives were to ensure adequate payroll and personnel internal controls are in place and functioning as intended, including:

- To evaluate internal controls regarding adding, modifying and removing employee information in the payroll and human resources systems.
- To verify that employee earnings, special payments, taxes, all deductions are accurate, complete and paid or deducted in a timely manner.
- To ensure that employment taxes, tax and non-tax reporting requirements comply with applicable federal/state laws.
- To ensure payroll transactions are properly classified, reconciled and posted to the appropriate general ledger accounts.
- To verify that payroll bank accounts are reconciled monthly, open items resolved timely and that the reconciliations have been reviewed by a supervisor.
- To identify improvements for the effectiveness and efficiency of operations.

Water Smart – Thinking in Terms of Tomorrow

Steven J. Elie
President

Michael E. Camacho
Vice President

Jasmin A. Hall
Secretary/Treasurer

Katie Parker
Director

Paul Hofer
Director

P. Joseph Grindstaff
General Manager

Audit Techniques Applied

Audit techniques applied during the audit included:

- Interviews of payroll, human resources, and other Agency staff
- Walkthroughs of processes and transactions
- Analysis of financial transactions and reports
- Review of supporting documents in SAP
- Review of policies and procedures
- Review of employee personnel data
- Review of payroll disbursements
- Review of bank reconciliations

Audit Results - Executive Summary

Payroll functions are shared between the Human Resources (HR) and the Finance and Accounting (FAD) departments. HR performs the new hire and separation timing and documentation as well as processes pay, deduction and benefit changes, which includes ensuring that pay rates are documented and all applicable payroll deduction documentation is signed by the employee. FAD processes biweekly and final payroll payments to employees which involves receiving employee timesheets electronically, resolving time entry and other payroll processing issues, processing payroll and ensuring all tax filing requirements and employee contribution designations are met. The audit noted that the HR and FAD departments provide effective and valuable payroll services to the Agency. We identified opportunities to further strengthen internal controls and the effectiveness of the payroll functions. The details of the observations and recommendations are included in the attached report.

- IA recommends that HR consider evaluating alternatives to automate some of the forms and the manual files used to maintain employee information, for example:
 - As discussed with HR, HR has already been working with Business Information Systems (BIS) to develop a self-service portal for employees to make direct changes and updates to certain information that currently requires a hard-copy document; such as withholding information, beneficiary information, address changes, or adding/deleting a family member from their policies, and changing contribution amounts to various plans.
 - The Agency is in the process of implementing a new enterprise content management system ("ECMS") using Laser-fiche. HR may want to consider whether the new ECMS would provide an automated approach to maintaining and updating employee information or whether another automated approach would be possible.
- As part of the Agency's disaster preparedness effort, HR should consider maintaining manual/hard-copy files in fire proof and water proof cabinets.

- As part of moving into a paperless, automated environment, HR should promote and encourage all employees to have their payroll related payments, including vacation and sick buy-backs made through direct deposits instead of manually writing paper checks.
- FAD should update Standard Operating Procedure No. CR PR-08 to reflect the new payroll bank reconciliation process, communicate the procedure to all department employees, and ensure the SOP is in the format outlined in accordance with Agency Policy A-51.
- FAD should ensure bank reconciliations are prepared monthly and supervisory review occurs in a timely manner to ensure any outstanding and reconciling items are researched and resolved.
- Both HR and FAD should encourage employees with payroll related functions to attend ethics and fraud awareness/prevention training specific to their job responsibilities to stay informed about new developments, risks and safeguards.

As a “next steps” plan, IA will survey comparable agencies to obtain independent insight into potential “best practices”. IA intends to work with HR and FAD to survey gather feedback related to items discussed in the audit report as recommendations for consideration. For example, items will include human resource and payroll automation tools, policies and procedures, direct deposit requirements and ethics/fraud prevention/awareness training. Information gathered will provide ideas and different methodologies employed by other agencies and provide options and direction for the Agency in implementing the recommendations in this report.

The Payroll Operations Audit is consistent with the Agency’s Business Goals of Fiscal Responsibility, Workplace Environment and Business Practices by providing an independent evaluation of IEUA’s payroll operations and making recommendations for improvements.

Acknowledgements

We would like to extend our appreciation to both the Finance and Accounting and the Human Resources departments for their cooperation and assistance during this review.

Discussion with Management

We provided drafts of this report and discussed the results of this audit with representatives of HR and FAD and have incorporated their comments into the report.

TV:ps

cc: Christina Valencia, Chief Financial Officer/Assistant General Manager
Shameen Bhojani, Manager of Human Resources
Javier Chagoyen-Lazaro, Manager of Finance and Accounting
Blanca Arambula, Deputy Manager of Human Resources
Suresh Malkani, Principal Accountant
Michael Arana, Payroll Accountant

Background Information

Internal Audit (IA) performed an audit of the Payroll function in 2010 and issued a report dated August 26, 2010 and performed a follow-up review in 2012 and issued a report dated August 6, 2012. Since the original audits, the Agency has implemented payroll/timesheet module in SAP. However, concerns associated with having up-to-date employee files and concerns about the timeliness of bank reconciliations that IA expressed in those reports continue to be an issue.

The Agency implemented the current payroll system in SAP in April 2013. The SAP payroll system made it possible for the Agency to eliminate paper timesheets and the manual recording and upload of employee time. Additionally, the SAP payroll system has improved labor cost reporting.

Payroll functions are shared between the Human Resources (HR) and the Finance and Accounting (FAD) departments. HR performs the new hire and separation processes which includes ensuring that pay rates are documented and all applicable payroll deduction documentation is signed by the employee. FAD is responsible for the recording, maintenance, and safekeeping of the Agency's assets and financial information. The payroll section is responsible for processing the biweekly payroll which involves receiving the supervisor approved, employee timesheets electronically, resolving time entry and other payroll processing issues, processing pay and ensuring all tax filing requirements and employee contribution designations are met. The Agency's payroll process is complex by nature, particularly with the many different bargaining units Memorandums of Understanding and the personnel manuals that apply and affect payroll.

All employee wage deductions must be authorized by the employee and/or are required by law. For tax deductions, the employee is responsible to elect the appropriate tax rate deduction based on marital status and other criteria. Payroll and deduction information is obtained by the HR department and should be filed in the employee's personnel file.

Payroll is distributed bi-weekly, with 26 payroll periods. There were 299 active employees paid on the Agency payroll as of January 6, 2017. During calendar year 2015-16, the Agency's gross payroll as reported to the Board of Directors was \$32,413,000. The Agency also paid employer and employee amounts of \$3,441,000 in Social Security and \$857,000 in Medicare taxes.

FAD and HR have documented Standard Operating Procedures (SOPs) for various activities related to payroll processes. The SOPs provide a manual to train and cross-train staff on the functions of the departments and to maintain consistency in operations. All SOPs are available to the employees in the department.

Report of Observations & Recommendations

Payroll Disbursement Testing

IA selected 25 employee's payroll disbursements from calendar year 2016 for pay period #1-2016, dated January 8, 2016. The sample was taken from a total population size of 287 employees in January with total gross wages paid of \$1,305,000. The sample represents approximately 10% of the gross wages paid, and over 8% of the employees on payroll. The sampled items included employees from each of the various bargaining units at the Agency. We reviewed transactions to ensure that:

- The pay rate on the payroll register/run matches the pay rate documented in the employees' personnel file,
- The pay rate paid agrees with the pay rate as documented in the corresponding MOU/Personnel Manual,
- Overtime, shift differentials, etc. were calculated correctly,
- Employee benefits were accurately calculated,
- Employee taxes were accurately calculated,
- Employee voluntary deductions were authorized by the employee and properly calculated (i.e. 401/457 contributions, etc.)

Manual files

Observation #1: The manual filing system used by HR has remained substantially the same since the payroll audit of 2010 while other Agency systems have been upgraded and/or automated to improve processes and increase effectiveness and efficiency. Manual files require, what can be seen as, a lot of paper and can be less efficient and are not currently maintained in fire proof or water proof cabinets.

Since the original Payroll audit, the Agency has undertaken multiple automation efforts that have increased the efficiency and effectiveness of processes and systems, for example with the Agency-wide Enterprise Resource Planning (ERP) and the implementation of SAP for most financial and timesheet processes, updated desktop software, the ongoing implementation of the SCADA systems for operations, project management with Primavera and Agency recordkeeping and public records requests with the rollout of the Laserfiche Enterprise Content Management System (ECMS).

HR continues to maintain manual personnel files for each employee that include information from the hiring process, all merit and cost of living increase information, including any employee reviews, employee federal and state tax withholding elections, and health and other benefit elections made by the employee, as well as personal and confidential information related to medical leave, and other.

In reviewing the HR files IA noted:

- Instances where information was misfiled in a different employee's file
- Instances where, for long-term employees, the files appeared to be large
- Instances where employee deduction elections were not up-to-date
- Instances where the employee reviews and merit increases were not completed or processed until after the employee's anniversary date resulting in the need to process retroactive payroll payments (In addition, retroactive payments resulted from the class and compensation study)
- Personnel files are not maintained in fire-proof or water-proof cabinets

Manual filing systems are prone to potential misfiling and are difficult to search, obtain and track information and to develop statistical summaries and overviews. It is also difficult to create back-ups of manual filing systems or house them offsite for safekeeping from potential disasters. Storing manual files requires having adequate space, and it can be costly to ensure fire proof and water proof security.

An automated system can provide multiple benefits, including back-up filing systems and security, having search and retrieve features and the ability to export summaries and analysis. Automation can provide additional tools for personnel activities, such as employee self-service for personnel changes, automated reminders of upcoming deadlines, automated entry of the annual benefits elections and new types of reports and potential comparative information. It would simplify the administrative processes for HR staff, allow changes to be processed more quickly and accurately and forms would not need to be routed, completed and potentially be delayed or misplaced manually.

Just as there are risks to manual files, an automated environment also comes with new risks, particularly for data security and the cost of implementation and maintenance. With HR data, there are also legal requirements to consider.

HR staff stated that public agencies generally rely on maintaining physical/manual files for personnel records that include all historical information for each employee. In discussing automating personnel records, HR stated having concerns about potential privacy issues with automated files. Further, HR staff indicated that Worker's Compensation litigation requires access to complete personnel files for review (complete meaning since the employee was hired). The department already scans appraisals and employee fact sheets as a type of electronic filing system however, most of the personnel files are maintained with manual/physical records.

IA recommends that, while keeping legal requirements in mind, HR consider transitioning hard-copy paper documents to an electronic management system for HR activities. The department could survey similar public service agencies and/or consult with professional organizations and government personnel attorneys to evaluate options and consider potential automated approaches (including the new enterprise content management system ("ECMS") using Laser-fiche the Agency is implementing) that could be more efficient, effective and secure for the Agency.

Recommendations:

1. IA recommends that HR consider evaluating alternatives to the manual files used to maintain employee information, for example:

- *Working with Business Information Systems (BIS) to develop or acquire a self-service portal for employees to make updates and changes to certain information that currently requires a hard-copy document, such as withholding information, beneficiary information, address changes, or for adding or deleting a family member from their policies, and contribution amounts to various accounts.*
- *The Agency is in the process of implementing ECMS. HR may want to consider whether the new ECMS would provide an automated approach to maintaining and updating employee information or whether another automated approach would be possible.*

Department Response: *HR stated they have already been working with BIS to determine personnel information that can be automated, for routine items such as changes to withholdings, beneficiary information or for adding or deleting a family member from their policies, address changes, contribution or banking changes. HR indicated that they have discussed with BIS the possibility of developing a self-service portal for employees. The costs to enhance the functionality of the system were considered to outweigh the benefits, however staff will continue to monitor this option.*

HR already scans the annual performance evaluations and Fact Sheets (checklist of changes) to create an electronic record and will continue to evaluate options, including the new ECMS system. As noted, HR has concerns about safeguarding the confidentiality of employee data and compliance with legal requirements.

Fire proof/water proof storage

IA noted that personnel files are maintained in steel cabinets, they are kept locked with key and are situated inside the Deputy Manager's office. The entire HR department is secured and not open/accessible to just anyone. While the files appear to be kept locked and in a secured location, the cabinets are not fire proof nor water proof. As part of the Agency's disaster preparedness efforts, HR should consider placing personnel records in fire proof and water proof file cabinets since some of the personnel hard-copy records are the only record available because most HR files are not automated. It is important to safeguard the only copy of the documents on hand.

Recommendation:

2. As part of the Agency's disaster preparedness effort, IA recommends that HR consider maintaining manual/hard-copy files in fire proof/water proof cabinets.

Bank Reconciliation Controls

Good business practices require that timely bank account reconciliations be performed monthly to ensure the bank statement issued by the financial institution matches the organization's internal financial records. The reconciliation is also a useful tool to identify any deposits, disbursements, outstanding checks, service fees, reconciling items and/or unusual activity that require further attention. Reconciliations should be reviewed and approved by a supervisor to ensure outstanding items are addressed and resolved appropriately.

During period under audit, the Agency used Bank of America (BoFA) for payroll banking activities. The activities included employee's payroll (paid biweekly via direct deposit), Board of Director's payments, and employee buybacks of unused sick leave and/or vacation hours. All payroll banking activities were processed through one bank account. Employee payroll taxes were paid through a separate BoFA bank account.

Below is a table showing the financial information related to the Payroll Bank Account only, it does not include taxes, CalPERS payments, and/or any other Agency-related benefits:

Bank of America - Payroll				
Period	Deposits and Other Credits	Withdrawals and Other Debits	Checks	Service Fees
January – December, 2016 (12 months)	\$28,174,063.55	(\$27,770,106.35)	(\$402,974.17)	(\$14,275.76)
January – April, 2017 (4 months)	\$10,189,710.40	(\$9,899,184.22)	(\$248,962.70)	(\$5,079.86)

Bank Reconciliations – Standard Operating Procedure (SOP)

Observation #2: FAD SOPs should be updated to reflect current practice.

Due to the recent changes with the Agency's banking institution and the implementation of SAP in 2013, the SOP Procedures No: CR PR-08 should be updated to reflect the new bank reconciliation processes.

In June 2017, the Agency transitioned payroll banking activities from BoFA to Citizens Business Bank (CBB) and began using a Zero Balance Account (ZBA) for all payroll payments. According to FAD, the purpose for changing banks is to streamline banking operations and save on banking fees.

Recommendation:

- FAD should update Standard Operating Procedure No. CR PR-08 to reflect the new payroll bank reconciliation process, communicate the procedure to all department employees and ensure the SOP is in the format outlined in accordance with Agency Policy A-51.***

Department Response: FAD intends to have the SOP updated by the end of the first quarter of Fiscal Year 2017-18.

Bank Reconciliations – Timely Bank Reconciliations

Observation #3: Bank reconciliations are not always prepared and reviewed in a timely manner.

FAD’s documented Standard Operating Procedure (SOP) (*Reconciliation of the Bank of America Payroll Bank Account, Procedures No: CR PR-08, effective July 1, 2012, Section 2.02*), states that the Bank Reconciliation is to be performed monthly, ideally within 30 days after month-end closing. For example, for the month of September, the reconciliation should be completed by October 31st.

IA reviewed the bank reconciliations, along with supporting documentation including the original and downloaded bank statements and reports from the Agency’s financial system (SAP), for Calendar Year 2016 and through April 2017. IA noted the following:

- Six of 16 (37%) reconciliations were not prepared in a timely manner
- Eight of 16 (50%) reconciliations did not have evidence of timely supervisory review

Findings related to the Bank Reconciliation

Year	Month	Prepared Timely	Reviewed Timely
2016	January	No – No date noted	No
2016	February	No – No date noted	No
2016	March	Yes	Yes
2016	April	Yes	Yes
2016	May	Yes	Yes
2016	June	Yes	Yes
2016	July	No	No - No date noted
2016	August	Yes	No
2016	September	Yes	No
2016	October	Yes	Yes
2016	November	Yes	Yes
2016	December	Yes	Yes
2017	January	No	No
2017	February	No – No date noted	No
2017	March	No – No date noted	No
2017	April	Yes	Yes

Previous Audit Observations:

As noted in the August 2010 Payroll Audit and the 2012 Payroll Operations Follow-Up audit, the timeliness of bank reconciliations for the payroll bank account has been an ongoing observation. The department’s procedures and controls still need to be strengthened to ensure bank reconciliations are prepared and reviewed timely.

A comparison of the timeliness of bank reconciliations from the current and prior audits shows:

Comparison of Bank Reconciliation Findings for three audits:

	Not Prepared Timely	No Evidence of Timely Supervisory Review
Current 2017 Audit	6 of 16 or 37%	8 of 16 or 50%
2012 First Follow-Up Audit	5 of 22 or 23%	5 of 22 or 23%
2010 Original Audit	14 of 23 or 61%	9 of 23 or 39%

When reconciliations are not performed timely, items that require immediate attention are not resolved. Although no employees went unpaid, reconciliations are an internal control and best practice to ensure questionable items are identified immediately, the lack of timely reconciliations has been noted by IA three times since 2010.

Bank Reconciliations – Outstanding Item Not Resolved Timely

IA noted an outstanding payroll check and an EFT return that both remained outstanding for more than a year. The outstanding check was issued on September 4, 2015 in the amount of \$2,077.77, while the EFT was a reconciling item for \$1,500.00 and was listed on the bank reconciliation since April 2016. IA notes that this was an unusual situation where the former employee could not be reached; however, there are other accounting practices that could have been employed to “resolve” the item and post it more appropriately and timely.

Department Response: *FAD noted that management approval has been obtained to address and resolve both matters in the May 2017 reconciliation. Agency legal counsel had been contacted several times about resolving the outstanding check since it was not cashed because the Agency was unable to locate the former employee. The outstanding check will be set up as a liability on the Agency’s records. The EFT return was resolved by posting offsetting journal entries to clear the general ledger account.*

Recommendation:

- 4. FAD should ensure bank reconciliations are prepared monthly and supervisory review occurs in a timely manner to ensure all outstanding and reconciling items are researched, investigated and resolved.**

Department Response: *FAD noted that some of the late reconciliations occurred because the responsible employee was out on FMLA leave and the department had not established a back-up process. FAD now includes the reconciliation deadlines on the department’s automated calendar and a secondary staff member has been assigned to serve as a back-up to ensure timely completion of bank reconciliations.*

Payroll – Manual Checks vs Direct Deposit

Observation #4: Agency uses direct deposits for all normal biweekly payroll transactions. However, manual checks are still prepared for two types of Payroll items: Vacation Leave Cash Out and Sick Leave Buy Back, as well as some members of the Board of Directors. The Agency should continue to move in the direction of paperless and automating processes that can be automated.

Annually, eligible employees may request to convert 70% of their annual vacation accrual into a cash payment. Specifics of this program are defined in each group's Memorandum of Understanding (MOU)/Personnel Manual. Payment for Vacation Leave Cash Out occurs in April of each calendar year. For sick leave, eligible employees may request to convert a specified amount of accrued sick leave hours into a cash payment. The MOU/Personnel Manual defines the requirements of the benefit and it is paid out to employees in December of each year.

In calendar year 2016, these two Payroll runs amounted to 216 checks and over \$370,000 in compensation. In these instances, the employees are paid via a separate, manually prepared check. Manual checks require additional staff time and resources for processing and preparation and can result in employee's losing or misplacing checks. Agency Policy A-54 (Direct Deposits of Net Payroll Checks & Retiree Longevity Payments, effective February 22, 2011) requires only that regular employee payroll and retirees be compensated via direct deposit. Changes to require direct deposit for Vacation Leave Cash Out and/or Sick Leave Buy Back program would require meet/confer processes with the associated Bargaining Units and re-negotiation of the MOU/Personnel Manual, which is in effect until June 30, 2018. IA encourages HR to take the lead and initiate discussions regarding direct deposits for all payroll related checks, in order to move towards a more efficient and paperless environment.

Recommendation:

- 5. As part of moving into a paperless, automated environment, HR should take the lead to promote and encourage having all payments made more efficiently through direct deposits instead of manually writing paper checks.***

Ethics and Fraud Awareness/Prevention Training Specific to Payroll Functions

IA recommends that all employees with payroll-related functions attend ethics and/or fraud awareness/prevention training specifically related to their job duties within payroll. Ethics/fraud awareness/prevention training will reinforce good internal controls and provide an opportunity to stay informed and about the latest potential risks and safeguards. The more informed employees are, the more likely they will be able to identify potential risks and breakdowns in internal controls. IA recommends that HR and FAD identify and share training opportunities for their staff and determine the type and length of time necessary for ethics/fraud awareness/prevention training.

Recommendation:

- 6. Both HR and FAD should encourage employees with payroll related functions to attend ethics/fraud awareness training specific to their job responsibilities to stay informed about new developments, risks and safeguards (for example, safeguards for potential payroll fraud, safeguarding personnel files and employee confidential information, etc.)***

Payroll Audit Follow Up – Best Practices Survey

IA has occasionally conducted surveys of comparable agencies to obtain independent insight into potential “best practices”. As a next step, IA intends to work with HR and FAD to develop questions for a survey of other agencies to better understand how they address their human resource and payroll activities. Items that could be considered for the survey include human resource and payroll automation tools, policies and procedures, direct deposit requirements and ethics training. The information gathered will provide ideas and different methodologies related to payroll processes and is intended to help with providing options or direction for the implementation of the recommendations noted in this report.

As “next steps” IA will begin drafting the survey questions and gather feedback from HR and FAD and gather a list of comparable agencies. Once results are gathered, IA will provide the information to both HR and FAD for their review and evaluation as well as report it separately to the Audit Committee and the Board. IA anticipates completing the survey by December 2017.

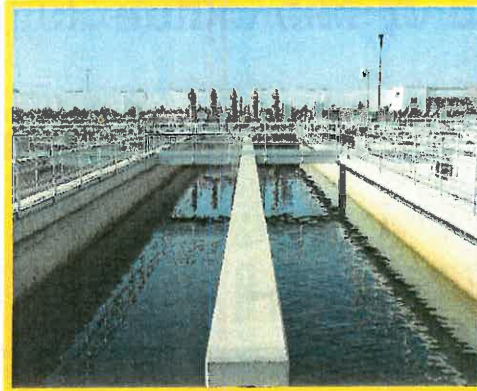
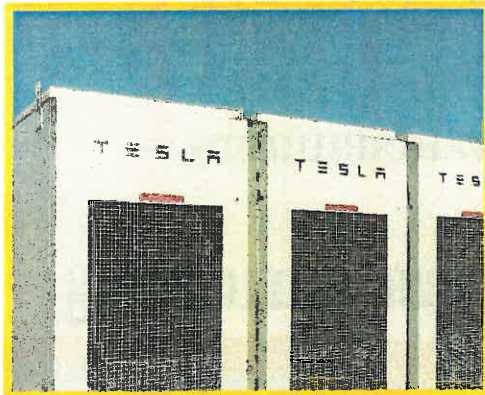
The Payroll Operations Audit and the proposed survey are consistent with the Agency's Business Goals of Fiscal Responsibility, Workplace Environment and Business Practices by providing an independent evaluation of IEUA's Payroll Operations and suggesting recommendations for improvements.

Attachment 1 – 2017 Payroll Audit Recommendations

Audit Report Date	Rec #	Recommendations
August 30, 2017	1	<p>IA recommends that HR consider evaluating alternatives to the manual files used to maintain employee information, for example:</p> <ul style="list-style-type: none"> • Working with Business Information Systems (BIS) to develop or acquire a self-service portal for employees to make updates and changes to certain information that currently requires a hard-copy document, such as withholding information, beneficiary information, address changes, or for adding or deleting a family member from their policies, and contribution amounts to various accounts. • The Agency is in the process of implementing ECMS. HR may want to consider whether the new ECMS would provide an automated approach to maintaining and updating employee information or whether another automated approach would be possible.
	2	As part of the Agency's disaster preparedness effort, IA recommends that HR consider maintaining manual/hard-copy files in fire proof/water proof cabinets.
	3	FAD should update Standard Operating Procedure No. CR PR-08 to reflect the new payroll bank reconciliation process, communicate the procedure to all department employees and ensure the SOP is in the format outlined in accordance with Agency Policy A-51.
	4	FAD should ensure bank reconciliations are prepared monthly and supervisory review occurs in a timely manner to ensure all outstanding and reconciling items are researched, investigated and resolved.
	5	As part of moving into a paperless, automated environment, HR should take the lead to promote and encourage having all payments made more efficiently through direct deposits instead of manually writing paper checks.
	6	Both HR and FAD should encourage employees with payroll related functions to attend ethics/fraud awareness training specific to their job responsibilities to stay informed about new developments, risks and safeguards (for example, safeguards for potential payroll fraud, safeguarding personnel files and employee confidential information, etc.)

AUDIT COMMITTEE

Payroll Operations Audit



Teresa Velarde, Manager of Internal Audit
September 2017

Payroll Operations Audit

Recommendations for Human Resources:

- Automation of personnel documents
- Self-service portal for employees to make direct changes and updates to information
- All payroll related payments through direct deposit not manual checks
- Safeguard all manual files in fire proof and/or water proof cabinets.

Recommendations for Finance & Accounting:

- Update Standard Operating Procedure No. CR PR-08 to reflect the new payroll bank reconciliation process
- Bank reconciliations should be prepared monthly and reviewed by a supervisor and outstanding issues should be resolved timely.

Payroll Operations Audit

Recommendation re Ethics Training

Both HR and FAD should encourage employees with payroll related functions to attend ethics/fraud awareness training specific to their job responsibilities to stay informed about new developments, risks and safeguards in those specific areas.

Payroll Operations Audit

NEXT STEPS: Survey of Comparable Agencies

Internal Audit will take the lead to complete survey:

- Automation tools, systems/programs
- Direct deposit for all types of payroll payments including leave
- Ethics/fraud awareness training

Anticipated date for Completion: December 2017



The End Questions or Comments?

The Payroll Operations 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
2C



Date: September 20, 2017

To: The Honorable Board of Directors

Chris Paul for JG
From: P. Joseph Grindstaff, General Manager

Committee: Special Audit Committee

09/20/17

Manager Contact: Teresa Velarde, Manager of Internal Audit

Subject: Internal Audit Department Status Report for September 2017

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. Briefly summarized here: During this quarter, IA completed the Payroll Operations Audit and the Contracts and Procurement Follow-Up Review. IA continues to work with all departments to implement recommendations and provide additional services. Both reports are under separate cover.

IA continues to assist with any requests for follow up work, review of Agency policies and procedures and separation of duties.

Staff's Recommendation:

This is an information item for the Board of Directors to receive and file.

Budget Impact Budgeted (Y/N): N Amendment (Y/N): N 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 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 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 of Agency financial and operational activities and making recommendations for improvement.

Attachments:

Attachment 1 - Internal Audit Department Status Report for September 2017

Internal Audit Department Status Report for September 2017

Projects Completed This Period

Audit: Payroll Operations Audit

Scope:

To ensure adequate payroll and personnel internal controls are in place and functioning as intended, and verify that employee earnings and deductions are accurate, complete and paid or deducted in a timely manner and match supporting documents. To ensure payroll bank accounts are reconciled monthly and open items resolved timely. To identify opportunities to improve internal controls and record-keeping.

Status: COMPLETE

IA has worked closely with the Human Resources (HR) and Finance and Accounting (FAD) Departments. IA has reviewed internal controls, processes in place and the supporting documentation for the activities involving payroll. The audit identified six observations resulting in five recommendations. Two recommendations suggest possibilities for greater automation of Human Resources and Payroll files/documentation and functions and two recommendations are about the importance of up-to-date bank reconciliations and processes. One recommendation emphasizes the importance of ethics training specific to payroll related activities and one recommendation recommends fire proof/water proof storage of manual personnel files.

IA will continue to work with HR and FAD to prepare and compile a survey of comparable agencies payroll and personnel policies and practices, the results of which will be presented in December 2017

The report is provided under separate cover.

Audit: 2017 Contracts and Procurement Follow-Up Audit

Scope:

IA completed a follow-up evaluation to determine the status of the two outstanding recommendations provided in the Contracts and Procurement (CAP) Follow-Up audit, dated August 29, 2012.

Status: COMPLETE

The two recommendations are now implemented. The first one was originally highlighted by the external auditors and related to removing a "superuser" authorization role that had been given to one member in CAP to be able to assist users during the initial implementation phase of SAP in 2007. The individual maintained the same authorization role for many years creating a risk to the Agency because the role allowed one individual to have the authorization to request, approve, process and receive orders/purchases, without another individual involved or aware of the process. Because the individual retired, there is no longer a conflict. The second recommendation was related to ensuring that for grant-funded projects, CAP verifies that vendors are not debarred by the federal government. The verification is completed online and CAP prints out the verification form as proof of checking. This process is documented in the Ordinance and the procedures.

The report is provided under separate cover.

Audit: Financial Audit

Scope: For the audit firm to express an opinion on the fair presentation of the financial statements

Status: Final work is scheduled for September/October

Internal Audit Department Status Report for September 2017

Lance, Soll & Lunghard, LLP (LSL), the Agency's external audit firm, will be on site for approximately two weeks beginning mid-September for final audit fieldwork and testing. IA coordinates with both Finance and Accounting and the External Auditors to review the financial statements and the Comprehensive Annual Financial Report. The role of IA is one of an added quality control check to check and double check totals, transfer of information and presentation. IA also reviews the requirements of the GFOA for the annual award.

Planned/Future/Additional Projects

Project: Wire Transfers and Electronic Disbursements Audit

Scope:

To evaluate the electronic disbursements of the Agency to ensure adequate segregation duties exists that no one person has the ability to initiate, approve and process electronic transfers. In addition, to evaluate the internal controls over the process to ensure sufficient oversight exists to prevent unauthorized electronic disbursements and payments.

Status: IN PROGRESS

IA will initiate this audit with a kick-off meeting in September with key representatives from the Finance and Accounting department. IA will perform preliminary surveys, planning, interviewing, analysis and inquiries of Agency personal in relation to Wire Transfers and Electronic Disbursements. Fieldwork is projected to begin in October 2017. The anticipated date for completion is December 2017.

Project: Procurement Cards (P-cards) Audit

Scope:

To evaluate the effectiveness of internal controls over the P-card program, and to ensure compliance with Agency policies and procurement processes. Additionally, to determine opportunities to improve administration of the program.

Status: IN PROGRESS

IA received the preliminary information requested related to the P-card program. IA will review the processes in place, financial transactions, and supporting documentation for purchases to verify compliance with the governing policies and procedures. The audit is being performed to review P-card activity to prevent misuse and errors. Anticipated Fieldwork is scheduled to begin in September 2017.

Proposed Completion: Planned date for completion is March 2018.

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

Internal Audit Department Status Report for September 2017

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":

- Continue to be involved with possible collection of the identified uncollected Connection Fees.
- Make recommendations about Maintenance, Construction Management and Contracts and Procurement Departments' concern/issue about a purchase requisition in excess of contract limits
- Participate in IT Security Committee
- Participate in the Safety Committee

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 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 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.

During this quarter, IA participated in Special Projects and appropriate reports have been made to Executive Management and the Audit Committee.

Trends in Internal Audit

DATA ANALYTICS

The use of "data analytics" is one of the newest trends in Internal Audit. Data analytics uses large amounts of data to uncover hidden patterns, correlations and other insights. Insights into developing a data analytics program were described in the August 2017 issue of "Internal Auditor" magazine. The suggestions were:

1. Create awareness: Insights from analytics are the result of the intersection between business awareness and the application of analytics tools and methodologies.
2. Understand the data: Evaluate, understand and validate data sources for business processes and the activities and decision-making they drive before investing in an analytics tool.
3. Plan sufficiently: Understand the system and data landscape, develop a training plan, seek business partner's input and identify which initial analytics are likely to yield valuable results.
4. Think big picture: Use analytics to support dynamic risk assessments, monitor trends and performance indicators to interpret data and model business outcomes.
5. Partner with IT: Develop a robust process for data acquisition; learn and apply data governance standards and practices to ease access.
6. Take advantage of visualization tools: Visually compelling, high-impact reports can help draw insights from the data.

The Agency's IA staff is considering the possibility of having the external auditors and perhaps a few data analytics providers make brief presentations to obtain an initial assessment of potential benefits for IEUA from employing data analytics.

Internal Audit Department Status Report for September 2017

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. Staff also attended a Fraud Seminar with the local IIA Chapter in San Gabriel.

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, 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, December 11, 2017 – Regularly Scheduled Audit Committee Meeting
- Monday, March 12, 2018 – Regularly Scheduled Audit Committee Meeting
- Monday, June 11, 2018 – Regularly Scheduled Audit Committee Meeting